MEMO May 3, 2007

To Commissioners, Martin, Kate, Robin

From Mike, Will

Re Work sessions, week of May 7, 2007, in the matter of NWE D2003.7.86 et al

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Attached is the draft of an order on Motions for Reconsideration. We asked for two work sessions so that the two main issues can be separately considered as each is, in its own right, somewhat complicated.

Service Date:

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER OF NORTHWESTERN ENERGY, Application for Approval of 2003 Avoided Cost Compliance Filing, Schedules QFLT-1 and STPP-1	))))	UTILITY DIVISION DOCKET NO. D2003.7.86 ORDER NO. 6501
IN THE MATTER OF NORTHWESTERN ENERGY, Application for Approval of 2004 Avoided Cost Compliance Filing, Schedules QFLT-1 and STPP-1	))))	UTILITY DIVISION DOCKET NO. D2004.6.96 ORDER NO. 6501
IN THE MATTER OF NORTHWESTERN ENERGY, Application for Approval of 2005 Avoided Cost Compliance Filing, Schedules QFLT-1 and STPP-1	))))	UTILITY DIVISION DOCKET NO. D2005.6.103 ORDER NO. 6501

ORDER ON MOTIONS FOR RECONSIDERATION

INTRODUCTION

1. In this order the Montana Public Service Commission (PSC or Commission) issues its decisions on motions for reconsideration (Motions) of Order No. 6501f ("Final Order" or "Order 6501f" hereafter). After Order 6501f was issued on December 19,

2007, the following parties filed Motions: NWE, MCC, CELP, Two Dot Wind and Whitehall Wind. In a February 13, 2007, Notice of Commission Action ("NCA") the PSC established a schedule for responses, allowing until March 13, 2007 for replies.

COMMISSION DECISION

2. The PSC divides the issues in the Motions into two areas, CELP related and non-CELP related qualifying facility (QF) rate issues.

I. CELP Related Motions for Reconsideration

3. Consistent with Order 6501f, the below findings are similarly categorized as follows: (1) Rate and Cost Issues, (2) Contract Issues and (3) Other Issues. Issues in Motions are first reviewed followed by a review of issues raised in briefs filed on the Motions, as allowed by the PSC's February 13, 2007 NCA. NWE's Motion raised just two CELP-related issues. CELP's Emergency Motion lists five CELP related issues, certain of which have multiple parts.

1. Rate and Cost Issues

4. Several interrelated rate and cost issues involve the cost of capital and tax effects. Although the PSC will distinguish certain aspects of these issues in the following findings of fact, others are unavoidably commingled given the commingling in the Motions and briefs. Thus, the following findings address three categories of rate and cost issues including: 1) the incremental cost of capital (ICC), 2) tax adjusted ICC and 3) escalation.

Incremental Cost of Capital

5. NWE Motion The first issue in NWE's February 5, 2007 Motion involves NWE's use of the allowed rate of return ("ARR"), in place of the incremental cost of capital ("ICC", sometimes referred to as the "incremental capital cost" in the following

findings), to compute the annual carrying charge (Order 6501f, footnote number 84).[1] NWE finds inaccurate the implication that it did not put the parties on notice until May 2006 of its use of the ARR. NWE asserts this is a significant misstatement of the factual record in an area of key concern. In support, NWE cites the testimony it submitted in D2002.7.80 as clarifying that the ARR was used as the marginal cost of capital ("ICC" hereafter) in the rate update. NWE said the testimony of its witness Mark Stauffer filed in D2002.7.80 "clearly states" that the ARR was used in place of the MCC (citing to page 13, lines 18-20 of that testimony). Second, NWE asks the PSC to review the record and make "appropriate adjustments."

6. CELP Response In its February 27, 2007 Response Brief, CELP asserts MPC and NWE "unilaterally and secretly" made changes after their 1988 First Amendment was executed. CELP lists as changes those that were made to indexes, the definition of the contract year (from a calendar year basis to an April to March basis), coal cost escalation, and many other "sneaky changes" identified in CELP's February 2, 2007 Motion. Although the First Amendment prohibits changes in the "identified methodology," MPC unilaterally eliminated the ICC by "surreptitiously" substituting the ARR. CELP said a "cursory" reading of Stauffer's testimony reveals no explanation for adopting the ARR. The referenced work papers also lack any discussion of the change. This total disregard for PSC orders should not be permitted. (p. 6) CELP said it had no economic interest or standing in contract year 2001-2002 to contest MPC's use of an ARR given the First Amendment fixed the rates for energy and capacity for the first 15 contract years. (p. 7) Thus, the only issues in "CELP's rate cases" from "1990 - June 2004" concerned escalating capacity and energy components that NWE failed to correctly implement but which were later corrected per a stipulation. (p. 7) CELP states to agree with the PSC that NWE unilaterally changed the methodology and the work papers disclose this was done without explanation. Thus, the PSC should find that

[1] Technically, the incremental cost of capital (ICC) is a reference to financing costs, whereas incremental capital costs is a reference to, for example, plant costs (see Order 5017a, Findings of Fact Number 14, 15, 16).

neither NWE nor MPC should be allowed to benefit and CELP should not be penalized for NWE's non-compliance. (p.7)

7. CELP also asserts NWE would like the PSC to discard the ICC in favor of the ARR. (p. 7) CELP said D83.1.2 refers to an annual ICC determination and not one for a different company and year as the PSC did in Order 6501f. CELP said the PSC's orders in D81.2.15 preclude the use of the "authorized rate of return" (presumed to equate to the ARR). CELP adds that NWE presented "no evidence" in this case as to the proper ICC. Thus, the only remaining evidence is Lauckhart's testimony.

8. Commission Finding The PSC noted the occasions when NWE has labeled the ARR either an ICC or a MCC (Order 6501f, Footnote Number 84).[2] That footnote did not state, nor is it a reasonable interpretation, that May 2006 was the first occasion on which NWE put the parties on notice of its use of the ARR in the annual carrying charge (ACC). The last time NWE filed an ICC for use with the QFLT tariff was December 28, 2000. That December 2000 filing resulted in MPC's non-transparent substitution of the ARR for what previously was an ICC (Order 6501f, footnote number 84).

9. The PSC disagrees with NWE's assertion that Stauffer filed testimony in D2002.7.80 that "clearly states" an ARR was used in place of the MCC (citing to page 13, lines 18-20 of that testimony). His testimony simply asserts: "Page 3 shows the capital structure used and the computation of the annual carrying charges. Page 4 shows the source of the capital structure as the latest approved by the MPSC for the Electric Utility." While the referenced work paper does equilibrate an ICC with the 8.464% capital cost, it does so without any explanation. An unreasonably low standard for transparency must be applied in order to find that NWE's approach comprised a clearly stated notice.

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[2] The PSC clarifies the second sentence in Finding of Fact Number 111 of Order 6501f. This sentence said Stauffer admits he neither used an ICC nor accounted for taxes when computing the QFLT rates that CELP is receiving, but asserts both were used when the rate was originally calculated. NWE does admit to not having recently used ICC values nor are the tax values that are used current. However, MPC previously used an ICC. NWE has always accounted for taxes when computing the QFLT rates. NWE must continue using an ICC and accounting for taxes.

10. The PSC finds that NWE's reference to and request for "appropriate adjustments" is too vague to allow the PSC to respond. Therefore, NWE's request is denied. The PSC affirms Finding of Fact 146, Order 6501f, wherein it ordered the use of the last approved ICC of 9.44%.

11. As for CELP's assertion that NWE presented no evidence as to the proper value for an ICC, the PSC would refer CELP to Footnote Number 65, Order 6501f. NWE has presented testimony on the ICC and its components. Finally, 9.44% is the ICC that NWE must use when finalizing rates in these three dockets and until such time as the ICC issue is thoroughly debated in a contested case and replaced by order of the PSC.

12. The PSC will next summarize CELP's Emergency Motion and the briefing comments by each of NWE and CELP on the subject of the ICC. This is followed by the PSC's findings on the same Motion and briefing comments.

13. CELP Emergency Motion The first of five issues listed in CELP's February 2, 2007 Emergency Motion regards the determination of the ICC. CELP asserts the PSC selected an ICC for use in 2004 and 2005 arbitrarily, capriciously and inconsistently with the references in the established methodology in D83.1.2 for determining incremental capital costs for NWE.[3] (p. 6) There appear to be two distinct parts to the issue. First, CELP characterizes as "erroneous" the PSC's finding that it "…will, in the future, give consideration to the relevance of substituting an ARR for an ICC, once a sound record exists and not before." (p. 7) Second, CELP asserts the PSC "…failed to follow the procedure set forth in the formula determining CELP's capacity and energy rate which dictates the manner by which the avoided cost rate is to be escalated for years 16 and beyond.[4]

14. The rate and cost aspect of this first part of the first issue in CELP's Emergency Motion appears to regard a dispute over NWE's use of the ARR and the

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[3] CELP states to limit its testimony to just 2005-2006 rates. TR 329-330

[4] As the PSC finds the second part of CELP's first issue to, in part, involve a contract matter that aspect is also addressed later in this order.

PSC's order requiring NWE to use a 9.44% ICC. CELP asserts NWE used the ARR without its prior agreement. CELP recites the PSC's finding that while an ICC estimate is a valid issue in an avoided cost docket the debate emerged too late for a robust record to develop and that, therefore, the PSC found merit in the last approved 9.44% ICC estimate. CELP asserts the PSC's decision lacks an explanation of how the 9.44% was calculated and, therefore, is erroneous, arbitrary and capricious given it is a 2001 estimate for MPC and is the wrong ICC in 2004/2005. CELP cites to Finding of Fact 34 (Order No. 4865). CELP adds it is irrational and unreasonable to select an ICC for the wrong company, let alone one that is out of time. CELP said Lauckhart presented the only evidence on ICCs that is consistent with D83.1.2. CELP also said Lauckhart's 10.5% was based on similarly situated utilities and is consistent with the methodology used previously by MPC and approved by the PSC. CELP said NWE produced no evidence as to the ICC and instead relied on cost based rates (embedded) that Order No. 4865 rejected. CELP adds that the record evidence does not support use of the 2001 ICC "…for a different investment grade company than NWE who in 2004 was a bankruptcy entity." CELP describes the contract years and asserts the matter of how to properly compute rates for the remaining contract years (16 to 35) is timely as the PSC has never "considered" the formula in the First Amendment. CELP concludes that the PSC's options are to either approve Lauckhart's 10.5% estimate or to grant reconsideration and reopen the record to establish NWE's ICC for the years in question.

15. NWE Reply On March 1, 2007 NWE replied to this first issue in CELP's Emergency Motion. NWE asserts CELP raised two arguments in stating the PSC has made an "erroneous" decision because it may do something in the future. CELP also attempts to tie this "potentially erroneous" future issue to negotiated contract formulae. (p. 2) In reply, NWE said the PSC did nothing erroneous as its order properly applied the ICC rate. NWE also said the PSC did not directly address the contract formula, which is a matter involving negotiations between the parties. NWE adds if CELP takes issue with any contract formulae, it can raise the issue in a court.

16. NWE said although CELP labels the PSC's decision "arbitrary and capricious," it cites no case law or definitional law for the argument. p. 2 The Montana

Supreme Court has addressed the standard definition (Silva v. City of Columbia Falls (1993)), characterizing such an argument as "random, unreasonable, or seemingly unmotivated, based on the existing record." (pp. 2-3) CELP's seeming argument, that the PSC should be bound by its own evidence, does not comport with applicable legal standard which permits the "finder-in-fact" to weigh the evidence and come up with the best decision.

17. NWE said even if CELP's argument is considered to have merit it is weak. Lauckhart testified in hearing and CELP argued post-hearing that an ICC should be imputed base on Southern California Edison's (SCE's) approved cost of debt. Lauckhart was not able to tie the similarity between SCE and NWE for purpose of the ICC whereas NWE argued 8.14% was the appropriate ICC. The PSC, however, rejected both NWE's and CELP's proposals.

18. NWE said CELP's argument that Lauckhart presented the only evidence on the ICC is "blatantly false" because NWE documented recent debt issuances to support the 8.14%. NWE asserts the PSC's ruling is proper and should stand. CELP's argument is an opportunistic attempt to "bump" up its contract payments. (pp. 2-3) NWE states CELP's position to use its ICC value for "two separate years," was not its position in hearing and is brought up at this "late date." CELP's argument to use its ICC for the two most recent "contract years," and not all three, is an attempt to "exaggerate the ratio" used to compute payments. That is, CELP's concern is not the appropriate use of timely data. Instead, CELP seeks a higher ICC in one of the two latter years. This would, however, cause an exorbitant boost in CELP's rates. As to this issue, NWE recommends denying CELP's Motion. (p. 4)

19. CELP Reply CELP filed on March 13, 2007 its "Reply" to NWE's "Response."[5] CELP's Reply contains five topics, the first three of which relate to the

[5] For clarification, CELP did file on February 27, 2007 a "Response Brief." However this Response Brief was a response to NWE's Motion, and not any "Response" as is suggested now in this March 13, 2006 CELP "Response." Therefore, the PSC presumes CELP is attempting to say that it is responding to NWE's March 1, 2007 Reply to CELP's Motion.

ICC. All topics include variations on the same theme: the relevance of PSC Docket No. D81.2.15 ("D81.2.15" hereafter). The first of the three ICC related topics has eight parts (assertions) and regards the determination of the ICC and "tax effect."[6] The second topic involves which ICC to select. While CELP labeled the third topic "MPSC Annual Rate Approval," it also appears to regard whether NWE should comply with D81.2.15 final orders. After summarizing the issues in these topics the PSC will summarize NWE's Reply, followed by the PSC's findings.

20. CELP first asserts in its March 13, 2007 Reply that Order 6501(f) misapplies Order Nos. 4865, 5017 and 5017a as shown by the MPC Order 4865 compliance dated February 25, 1982. CELP adds "…MPC work paper page 4 of 7 of Exhibit A clearly shows annual carrying charges including incremental capital cost including tax effect calculated consistent with the definition of the glossary to Order No. 5017."

21. Second, CELP asserts in its March 13, 2007 Reply that PSC Order 4865b requires MPC to submit final avoided costs including ACCs in the February 25, 1982 compliance filing of 20.04% for a base load plant and 21.87% for a combustion turbine (CT). (p. 2) CELP concludes there can be no doubt that MPC's Order 4865 compliance, and Order No. 5017 together with the glossary definition, requires NWE to include the ICC with tax effects, as shown in Appendices A and B of Order No. 4865. (p. 2)

22. Third, CELP next asserts in its March 13, 2007 Reply that the 1982 compliance filing was the first and only MPC compliance filing to follow Finding of Fact 34 of Order 4865 directing that capital costs be annualized by applying the overall ICC including tax effect, not embedded cost of capital including tax effect. Such filings are to be updated annually to reflect the contract year's capital market. CELP adds that unlike any other MPC compliance filing since 1982, MPC computed the Baseload and the CT carrying charges [variables (c) and (d) of the long-term energy and capacity rate formulas set forth in Appendix B of Order 4865] in a manner that includes both the ICC and the tax effect.

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[6] While this topic commingles ICC and tax effects, the PSC will address both in different parts of this order.

23. Fourth, CELP asserts in its March 13, 2007 Reply to further clarify that the ICC including tax effect was always intended to be applied in the D83.1.2 methodology. CELP said MPC filed a November 21, 1983 Motion for "Clarification and Reconstruction" (sic) in D83.1.2 in which it asked why the cost of capital did not include the ICC including tax effect for determining the cost of QF electrical interconnection instead of just the incremental capital cost as provided in Finding of Fact 89 of Order 5017. (pp. 2-3) CELP adds "In order to be consistent for the determination of MPC's and QF's interconnect capital cost for interconnection, the MPSC granted MPC's request for interconnection costs to include appropriate allocation of general and common plant and income taxes…" (citing Finding of Fact 33 of Order 5017a, emphasis added). CELP then concludes the MPSC clearly recognized the incremental cost of capital included tax effect when the adjustment was made for interconnect capital costs for determining carrying charges. CELP further adds that both Orders 5017 and 5017a include the incremental costs including tax effect and that CELP's annual rates must include the same.

24. Fifth, CELP next asserts in its March 13, 2007 Reply that while MPC may have "historically confused" the PSC in its 1983 and 1984 compliance filings and improperly deleted the ICC including tax effect from carrying charges, CELP is clearly entitled to a calculation beginning in the 16th contract year, under Attachment 1 and Tables I and II of the First Amendment that includes both the annual ICC and tax effect as required in "Order No. 4865, Appendix B and Order No. 5017, Finding of Fact 50, and included in the MPC order no 4865 compliance." CELP adds there can be no other rational analysis, especially in light of the clear definition of carrying charges in the Order No. 5017 glossary, other than to include the ICC including tax effect. (p. 3)

25. Sixth, CELP asserts in its March 13, 2007 Reply that the PSC's Order No. 6501f suggests the annual inclusion of ICC including tax effect is double counting. (p. 4) CELP adds, the PSC's concern with double counting of the ICC including tax effect (Order No 6501f Finding of Fact 147) in determining carrying charges (defined in Orders 5017 and 4865 Appendix B) is mistaken. CELP further adds while it is beyond dispute that D83.1.2 and Order 5017 included the ICC including tax effect, the PSC "suggests" in Order 6501f that the 1983 and 1984 MPC compliance filings somehow changed the

substance of Order Nos. 4865, 5017 and 5017a by deleting the tax effect from the ICC used to determine ACCs. CELP also said MPC's February 25, 1982 compliance filing to Order 4865 clearly shows the ACC components and revenue requirements for both the Baseload and the CT ICC were increased for tax effects. In this regard, CELP cites to a February 25, 1982 letter from MPC's Jack Haffey.

26. In its seventh assertion in its March 13, 2007 Reply (pp. 4-5) CELP said the PSC confirmed MPC's inclusion of incremental costs including tax effect in the PSC's March 1982 COG/SPP filing avoided cost rate determination work papers. CELP said the work papers confirm that the method used in MPC's February 25, 1982 compliance to calculate carrying charges includes the ICC and tax effects. CELP asserts that by combining the methodology in Order 4865 with MPC's compliance filing, and the PSC's compliance filing of March 1982, there can be no doubt Order 5017 incorporated the method of Order 4865.

27. CELP's eighth assertion in its March 13, 2007 Reply (pp. 4-5) states the PSC lawfully created Order Nos. 4865 and 5017 and that CELP and MPC embodied such orders without changes in Attachment 1 and Tables I and II of the First Amendment. MPC and its successor NWE entered into a contract with CELP to include the D83.1.2 methodology including Orders 5017 and 5017a. CELP said the parties did not contractually adopt the 1983 or 1984 methodology in MPC's compliance filings in CELP's First Amendment although Order 6501f relies upon those compliance filings to eliminate tax effect from the cost of capital for purposes of computing carrying charges. CELP concludes the PSC cannot lawfully seek to change definitions to allow NWE to escape the economic consequences of NWE's compliance with CELP's contract.

28. CELP's second topic in its March 13, 2007 Reply addresses the selection of an ICC. CELP first asserts NWE in its "Response Brief" and in Stauffer's testimony sought to use the Authorized Rate of Return for MPC determined in 2000 instead of the ICC. CELP also asserts NWE introduced no other ICC evidence for NWE in 2004 and 2005 consistent with Order 5017 (Findings of Fact 50, 54 and 55) to determine the annual rates as required by the First Amendment (Tables I and II). Thus, Lauckhart's testimony is the only ICC evidence and the PSC "should accept such evidence." CELP then cites to

Dr. Tom Power's D81.2.15 testimony asserting his testimony provides grounds to accept Lauckhart's testimony as a correct measure of the ICC.

29. CELP's third topic in its March 13, 2007 Reply addressed what it labels the "Annual Rate Approval." CELP makes three assertions in this regard. First, CELP cites Lauckhart's testimony to explain why CELP did not object to the exclusion of tax effects from the carrying charges in variables (c) and (d) in D83.1.2 in 1983 for contract years 1-15. CELP itemizes four statements that Lauckhart made: (1) there was nothing wrong in 1983, rather the source of the problem is NWE's failure to properly calculate rates consistent with such orders (5017, 5017a, 4865 and 4865a, b, and c), the 1982 MPC compliance filing and the 1982 PSC workpapers; (2) the First Amendment did not require NWE or CELP to begin computing CELP's rates that include Baseload and CT carrying charges [variables (c) and (d)] until the sixteenth contract year; (3) it is curious why the PSC looked to CELP for why it had not noticed NWE had not followed the terms of the 1982 and 1983 orders and that the PSC completed workpapers in 1982 correcting MPC's failure to follow order 4865b; and (4) that CELP has timely brought its concerns involving the year 16 contract to the PSC.

30. Second, CELP asserts MPC's December 20, 1983 cover letter stated that the workpapers will show income tax etc., adders to the ICC estimates to be filed. CELP concludes, with apparent reference to MPC's compliance filing, that for NWE to suggest the PSC can change the methodology in its orders, without due process because the PSC has some newly asserted authority to change in 2007 final orders entered in 1983 and to thereby negotiate or mandate a new rate methodology, is truly amazing and outside both the law and CELP's First Amendment.

31. CELP's third assertion under this third topic holds the PSC should simply use Appendices A and B of Order 4865, the 1982 compliance filing and the 1982 PSC workpapers, tariffs etc., and recalculate the 16th year (2004-2005) rates and the 17th year rates in a manner that includes the ICC and the tax effect.

32. NWE Consolidated Second Reply On March 15, 2007 NWE filed its Second Reply. NWE asserts if the PSC chooses to reach to the "merits" of CELP's response (presumably a reference to assertions in CELP's March 13, 2007 "Reply"), then

the PSC should not accept CELP's characterization of the rate of return issue. NWE said the essential issue is not as CELP says the use of the ARR or the ICC, but rather the consistent application of the PSC's decision. NWE denies asking the PSC to "discard" the ICC in favor of the ARR. NWE said the PSC should be consistent regarding the cost of capital in every year. NWE agrees with the PSC that the "larger cost of capital issue" should be addressed in the 2006 docket. The PSC should disregard CELP's effort to breathe new life into the cost of capital issue.

33. Commission Findings The PSC, in turn, responds to the material in CELP's February 2, 2007 Emergency Motion, CELP's March 13, 2007 Reply and NWE's March 15, 2007 Second Reply. As for the first issue in CELP's February 2, 2007 Motion, CELP does not appear to understand the basis upon which the PSC said it may substitute an ARR for an ICC (or MCC). As the PSC explained, after a thorough airing in a contested case of the ICC issue it could be that the best estimate of an ICC is the ARR. The PSC did not then nor does it now, and may not in the future, reach that conclusion. But, it is conceivable that cost of capital experts might find the ARR to be a valid measure of the ICC. There is no further need to debate this issue as the PSC has not conducted such a proceeding nor reached such a conclusion.[7] But, for CELP to foreclose such a consideration, and label it "erroneous," is premature. There is, however, need for a more thorough airing in a contested case of what the best measure is of NWE's ICC (or MCC), which involves the second part of this the first issue in CELP's Motion.

34. As for the second part of this first of five issues in CELP's February 2, 2007 Emergency Motion, the PSC finds that until the next opportunity emerges to develop a

[7] The PSC notes NWE's earlier defense for using the ARR in place of the ICC (NWE used marginal cost of capital in place of ICC). NWE's defense includes the following: (1) the ARR is stable and non-controversial. In contrast, if the ICC is to be decided anew each year, it will be contentious; (2) the ARR is decided in a forum wherein experts debate the issues. The ARR also complies with the FERC's avoided cost requirement. Use of the ARR also conforms to the intent of Finding of Fact 34 and (3) since Finding of Fact 34 does not require the use of the ARR or the ICC, the PSC should apply the index that best insulates ratepayers and that keeps them indifferent as to a purchase from a QF rather than a built plant (see NWE September 13, 2006 Reply Brief to CELP's Response Brief, pp. 7-8).

comprehensive record the last (2001) PSC approved ICC will be used. The present record is simply to thin a basis upon which to do other than maintain the status quo. The PSC will not as CELP suggests reopen this record for a debate. There is an ongoing QF docket (D2006.6.94) in which the record on the cost of capital could and should be developed. In fact, CELP's own witness Lauckhart recommended implementing his proposals in NWE's "next rate filing."[8]

35. The PSC will now respond to each of the eight arguments in the first topic contained in CELP's March 13, 2007 "Reply." First, the PSC finds that CELP confused the logical sequence of orders and of compliance. No order out of Docket D81.2.15 need be "consistent" with any subsequent avoided cost docket's final order as CELP suggests. That is, the PSC did not require compliance filings in D81.2.15 to comply with an order that would not be issued until a later date in a subsequent docket (Order 5017, D83.1.2). Thus, for CELP to say the D81.2.15 compliance of February 25, 1982 is consistent with the glossary in Order 5017 is irrelevant to whether NWE's filings in D83.1.2 comply with Orders 5017 and 5017a.

36. As for CELP's assertion that the parties did not contractually adopt the 1983 or 1984 methodology, the PSC would note that the First Amendment makes explicit reference to D83.1.2 orders, not D81.2.15 orders, and then actually cites rates contained in the 1984 compliance filing to Orders 5017, 5017a. That compliance filing imbeds the methodology established in D83.1.2 orders.

37. To continue, CELP errors when it suggests that compliance filings in response to PSC orders in D83.12 (5017, 5017a) must comport with Appendices A and B of Order No. 4865. If in citing D81.2.15, and the carrying charges values of 20.04% and the 21.87%, CELP is suggesting the same values or the same method must be used to compute avoided costs that are compliant with Orders 5017 and 5017a, CELP is wrong. If that is its intent, CELP simply refuses to acknowledge the change in methodology, not to mention the timing difference, between D81.2.15 and D83.1.2. If CELP cites these

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[8] See Order 6501f, Finding of Fact Number 99.

values and the associated text to buttress its case that NWE's compliance in D83.1.2, must combine tax effects with ICC, the PSC agrees, as noted in Order 6501f: The MPC compliance filings the PSC cited in Order 6501f combine tax effects and the ICC, at least up until the time that MPC substituted an ARR for the ICC.[9] The PSC has now required NWE to reverse that less than transparent substitution and again use the ICC, not the ARR. If CELP intends something else by citing these D81.2.15 values, it is not transparent. The PSC would only add CELP has padded the evidentiary record with arguments and information not raised in these consolidated QF dockets.

38. As for CELP's third assertion in its March 13, 2007 Reply, the PSC would first note this is also new material. The PSC would only add this material is not clearly relevant to how NWE must comply with the changed methodology ordered out of D83.1.2. As an aside, CELP's intent for including the last full paragraph (p. 2 of CELP's March 13, 2007 Reply) is unclear. In Order 6501f the PSC cited, for example, two compliance filings out of D83.1.2, both of which include the ICC with tax effects in the ACC. Further, it is the methodology in the D83.1.2 compliance filings that clearly appears the basis of CELP's First Amendment with MPC.

39. The PSC finds CELP's fourth assertion in its March 13, 2007 Reply to involve interconnection policy and not avoided cost rates. In addition to being new material that CELP had not previously included in testimony, it is not clearly relevant to matters involving avoided cost rates and therefore has no clarifying value.

40. As for CELP's fifth assertion in its March 13, 2007 Reply, the PSC would first note that this is, with the exception that carrying charges must include the ICC and tax effects, also new information not included in any CELP testimony. The PSC only agrees with this exception and has ordered NWE to use the ICC.

41. The PSC does not agree that MPC confused the PSC in its 1983 and 1984 compliance filings. The compliance filings the PSC cited include the ICC and tax effects. These filings were publicly available for all D83.1.2 intervenors and others, such as

[9] Tax effects are included but have been held constant since 1988 (Order 6501f, Finding of Fact 112).

CELP (or its predecessor), to view and they were compliant with the new and changed methodology established in D83.1.2. If there is confusion, it remains with CELP. If CELP is suggesting the method used to compute carrying charges in its First Amendment requires use of the method established in Order 4865 (D81.2.15), then this is a contract matter; this is not the methodology the PSC established in D83.1.2 and not the policy with which NWE must now comply when making compliance filings for D83.1.2. Aside from having to annually update the STPP (Short Term Power Purchase), NWE has not made a D81.2.15 compliance filing for about two decades, nor does it now need to make such a compliance filing.

42. As to CELP's sixth assertion in its March 13, 2007 Reply, the PSC did not find or suggest, as CELP has less than artfully re-worded the PSC order, that including the effect of taxes in the ICC is double counting. The PSC did find that because tax effects were included in the compliance filings (citing the 1983 and 1984 filings) in D83.1.2 to change the established method to include taxes a second time would be double counting. Thus, the PSC disagrees with CELP's assertion that Order 6501f was mistaken with respect to Orders in D83.1.2.

43. The PSC did not suggest in Order 6501f, as CELP also asserts, that the 1983 and 1984 compliance filings changed the substance of D81.2.15 and D83.1.2 orders to, in turn, exclude tax effects. As for CELP's citation to a letter from Jack Haffey, the PSC would note this information appears new and there is no apparent relevance given the letter regards the D81.2.15 methodology. Finally, the PSC's Order 6501f contains no mention of "double counting" at Finding of Fact 147, as CELP asserts.

44. CELP's seventh assertion in its March 13, 2007 Reply, also makes new arguments. The PSC has required the inclusion of tax effects and use of the ICC in compliance filings pursuant to D83.1.2. CELP's seventh assertion appears an attempt to make NWE use the D81.2.15 method when it files rates in compliance with D83.1.2. Aside from continuing to require NWE to include tax effects with the ICC, the PSC disagrees with CELP. If the First Amendment CELP has with MPC requires use of the carrying charges as established by the D81.2.15 methodology, then that is a contract matter, aside from the fact the PSC disagrees with such an interpretation of the First

Amendment.[10] CELP and NWE can, as necessary, further debate this contract matter in a court. CELP's assertion that the PSC made a compliance filing in 1982 is obviously incorrect. The PSC would also note that whereas in Order 6501f it had separated rate and cost issues from contract issues, CELP's March 13, 2007 response clearly commingles the two. Thus, for efficiency, as evident from these findings, the PSC has not separated out the contract issues that CELP appears now to raise.

45. As for CELP's eighth assertion in its March 13, 2007 Reply, the PSC disagrees with CELP's statement that the PSC in Order 6501f relied on the compliance filings to eliminate tax effects. To the contrary, the PSC relied on the compliance filings to establish that tax effects were included. Thus, to add tax effects again, as CELP now wishes, would be double counting. The balance of CELP's assertion simply involves its interpretation of its contract, a matter that need not be further debated.

46. The PSC is compelled to reiterate one point. It appears CELP is in denial of the change in methodology that occurred between D81.2.15 and D83.1.2. Although both dockets require use of the ICC with tax effects, the methodologies in the two dockets differ. They differ in ways that CELP appears unwilling to acknowledge. CELP's failure to acknowledge this fact has resulted in the expense of inordinate amounts of time.

47. That CELP refuses now to acknowledge that its contract was tied directly to D83.1.2 compliance filings is also inconsistent CELP witness Orndorff's testimony.[11] As CELP explained, in place of the first year partially levelized energy and capacity rates (3.751¢/kwh and $91.54/kw/yr, respectively) in docket D83.1.2, CELP's rates began at 2.222¢/kwh and $55.94/kw/yr. *DR PSC-020(b)*. If one compares these 3.751¢/kwh and $91.54/kw/yr rates to those in MPC's June 18, 1984 compliance filing (p. 5/56) there is an exact identity with rates in MPC's 1984 D83.1.2 compliance filing. The First Amendment cites other rates (e.g., the $.03644/kwh energy rate) to anchor the basis of the First Amendment to MPC's D83.1.2 1984 compliance filing. Therefore, CELP's

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[10] As documented in detail later in this order, the First Amendment makes explicit reference to D83.1.2 and rates in MPC's 1984 compliance filing.

[11] See Order 6501f, Finding of Fact Number 59.

effort to exhume the D81.2.15 methodology and rates and then base its First Amendment contract rates on orders out of D81.2.15 is not credible.

48. As for the second topic in CELP's March 13, 2007 Reply and the relevant ICC, the PSC agrees with CELP that in Stauffer's testimony NWE "sought to use the Authorized Rate of Return for MPC determined in 2000 instead of the ICC." This error was addressed in Order 6501f.

49. As for CELP's assertion that NWE introduced "no other evidence of ICC for NWE in 2004 and 2005 consistent with Order 5017 (Findings of Fact 50, 54 and 55) to determine the annual rates as required by the First Amendment" and that the only ICC evidence is in Lauckhart's testimony, the PSC disagrees. Clearly, NWE filed testimony that challenged CELP's testimony. As for CELP's request that the PSC "should accept such evidence," the PSC has never ruled that CELP's testimony is not part of the record.

50. As for CELP's reference to Dr. Tom Power's D81.2.15 testimony and its assertion that Power's testimony provides grounds for uniquely accepting Lauckhart's testimony as a correct measure of the ICC, the PSC has not reviewed Power's testimony to discern its relevance to and its unique support of Lauckhart's testimony vis-à-vis NWE's testimony, or any decision the PSC has made. CELP's reference and its assertions are newly made and out of time.

51. As for the third topic labeled "Annual Rate Approval" in CELP's March 13, 2007 Reply, the PSC's findings are as follows. First, CELP asserts there was nothing wrong in 1983, rather the source of the "problem" is NWE failed to properly calculate rates consistent with such orders (5017, 5017a, 4865 and 4865a, b, and c), the 1982 MPC compliance filing and the 1982 PSC workpapers. While the PSC finds unclear CELP's alleged "problem," the 1982 compliance filing is not relevant and its reference to "1982 PSC workpapers" is unclear.

52. As for the second item under the third topic, that the First Amendment did not require NWE or CELP to begin computing CELP's rates that include Baseload and CT carrying charges [variables (c) and (d)] until the sixteenth contract year, the PSC has no comment as this is a contract matter.

53. As for CELP's assertion under the third topic that it is curious why the PSC looked to CELP for why it did not notice NWE had not followed the terms of the 1982 and 1983 orders and that the PSC completed workpapers in 1982 correcting MPC's failure to follow order 4865b, the PSC has several comments. This assertion appears to raise a new argument, one that is incomprehensible. Again, unless CELP is addressing a contract matter, in which case this assertion belongs in a court, the reference to D81.2.15 orders and the alleged PSC workpapers in 1982 have no bearing on how NWE must now comply with the final orders out of D83.1.2. CELP's reference to PSC workpapers is also a new and unclear reference.

54. The PSC is doubtful about CELP's assertion under the third topic that it has brought to the PSC on a "timely basis" its concerns involving the year 16 contract. CELP's assertion, to have known for 15 years that MPC and NWE made filings in compliance with D83.1.2 that were errored because they should have complied with D81.2.15, seems inconsistent, unless of course this is a contract matter. If it is a contract matter, then it should not have been raised with the PSC and, in turn, there is no sense in which it could be "timely."

55. The PSC will next address another assertion CELP made under the third topic. CELP cites to a December 20, 1983 MPC cover letter. CELP asserts that for NWE to suggest the PSC can change the methodology in its orders without due process, because the PSC has some newly asserted authority in 2007 to change final orders entered in 1983 and to thereby negotiate or mandate a new rate methodology, is truly amazing and outside both the law and CELP's First Amendment.

56. First, as this is new the PSC may not comprehend CELP's assertion. If CELP's concern is with the PSC having allowed MPC to substitute the ARR for the ICC, the issue was addressed. If CELP is obliquely addressing whether the ICC needs to be adjusted for taxes, that issue has also been addressed. If CELP is holding the PSC violated due process when in D83.1.2 it changed the methodology previously established in D81.2.15 that would then be used to compute rates, the PSC disagrees. If CELP means something else by this new argument, then what it meant is incomprehensible, which is

always a risk when a party raises a new argument and includes new information in Motions and, or, briefs on Motions.

57. As for CELP's final assertion that the PSC should simply use Appendices A and B of Order 4865, the 1982 compliance filing and the 1982 PSC workpapers, tariffs etc., and recalculate the 16th year (2004-2005) rates and the 17th year rates in a manner that includes ICC and tax effect, the PSC disagrees. Although a new argument by CELP, this one is comprehensible. CELP requests that the PSC use the D81.2.15 methodology to calculate rates that must comply with D83.1.2. This request is denied. Again, CELP appears unwilling to acknowledge that the methodology established in D83.1.2 differs from the methodology established in D81.2.15. As the PSC noted earlier, it is D83.1.2 upon which the First Amendment appears based. The PSC cannot and will not respond to CELP's vague reference to PSC workpapers.

58. As for NWE's March 15, 2007 Second Reply and assertions, the PSC responds as follows. First, it is not entirely clear what NWE means when it asserts the PSC needs to be "consistent." If this assertion is meant to require use of the ICC with tax adjustments as has been required and as is evident from MPC's early compliance filings in D83.1.2, the PSC agrees. Second, as for NWE's assertion that the PSC should disregard CELP's effort to breathe new life into the cost of capital issue, the PSC disagrees. NWE must address the ICC in subsequent compliance filings. The PSC expects that the basis of annual ICC estimates will require support in the form of NWE testimony. In summary of this issue, NWE must re-compute rates for each of the three consolidated dockets that include 9.44% as the ICC. This and any other revisions must be reflected in work papers filed in compliance with this order.

Tax Adjusted ICC[12]

59. CELP Motion In the second of five issues in its February 2, 2007 Emergency Motion CELP first asserts the PSC arbitrarily and capriciously excluded the "tax effect" in annual updates of the ICC, a decision contrary to the formula CELP and

[12] Unavoidably the issue of tax adjusted ICC was also discussed above. For a complete understanding of the PSC's response the reader is advised to read this entire order.

NWE agreed to and that references D83.1.2. (p. 6) CELP adds the PSC ignored the mandate to include tax effects, as required by Order 4865, and as required by "the formula" adopted in Order Nos. 5017 and 5017a: "… refinements…are not intended to abrogate existing contracts." (Order 5017, ¶ 12) CELP also said the PSC (Order No. 6501f, Finding of Fact 147) omitted significant information from D81.2.15 and D83.1.2 that regards the proper development of avoided cost rates. (pp. 11-12)

60. In this second issue in its Emergency Motion CELP also asserts the PSC omitted reference to Order 4865. (p. 12) CELP cites to the referenced June 1984 compliance filing, that the PSC's order cites (Order No. 6501f, Finding of Fact 147), to have revealed that the ICCs for Colstrip 3 & 4 and a CT were 13.15% and 13.90% respectively. CELP notes the values for variables "c" and "d" for Colstrip 3 & 4 and a CT in Order 4865 were 16% and 17% respectively. CELP concludes that "without some other explanation it appears the ICC figure used "**was** adjusted" in the 1984 filing contrary to what was contained in PSC Finding Number 147 to include "tax effect." CELP holds that by not using the tax effect with the appropriate ICC for NWE, the PSC violated its own orders and did not follow the contract requirements of the First Amendment.

61. CELP also asserts the PSC ignored Lauckhart's testimony demonstrating that in all years prior to 1991 MPC "consistently annually recalculated" the QFLT rates using the current state and federal income tax rates for that year to determine the ICC. (p. 12) CELP said MPC "in 1992 and thereafter beginning in 1994," and without PSC approval, changed the Order No. 4865 methodology to ignore "tax effect." MPC and NWE decreased the ICC by not including tax effect. The PSC acted arbitrarily and capriciously by not following Footnote Number 1 to Schedule QFLT-84 requiring that "escalating" rates are determined each year and that states: "These rate levels are subject to annual revision in accordance with MPSC No. 5017." (emphasis added) CELP said "no portion" of D83.1.2 "or" any order "provides" any annual update that does not include "tax effect" to determine the ICC. CELP said the PSC has invented a new methodology. By excluding tax effect the PSC changed the D83.1.2 methodology and the resulting ICC is therefore inconsistent with the First Amendment. CELP said that in

order not to violate the First Amendment the PSC must compute the ICC as the methodology existed in 1988.

62. Last, and also in regard to the second issue in its February 2, 2007 Emergency Motion, CELP asserts it is entitled, starting on July 1, 2004, to the "grandfathered rates" in Schedule QFLT-84 based on an annual rate determination for escalating energy and capacity and partially escalating energy and capacity. Once the PSC computes Schedule QFLT-84 consistent with Order No. 4865 and Docket No. 83.1.2, CELP said it will apply the variables to the "Power Purchase Agreement" to determine any rates, with any disagreement to become a court matter. (p. 14)

63. CELP Response Although NWE's Motion contained no discussion of tax effects, other than to generally assert the PSC's Order resolved many longstanding issues, CELP includes in its February 27, 2007 Response Brief assertions that presume a NWE Motion. In this regard, CELP appears to pad its Emergency Motion and not respond to the Motion of any party. In any case, the PSC will review here the content of CELP's Response. CELP also raises a new compliance filing issue.

64. CELP asserts NWE created great confusion over whether tax effects had been properly included. CELP asserts NWE succeeded in getting the PSC in Order 6501f to mistakenly eliminate the "tax effect" clearly adopted and required in Order Nos. 4865 (Finding of Fact 34) and 5017 (Findings of Fact 50, 54, 55). CELP goes on to state the PSC determined that under the "fully escalating" rate option annual rate determinations would "simply equal the Base Long-Term Rates" as updated each year. (p. 4) After reciting Order 5017's composition of carrying charges (e.g., return on debt, equity, income taxes etc.,) CELP said the carrying charges, including the ICC with tax effect, as defined in the glossary to Order No. 5017, are "then" (emphasis added) included in Appendix B to Order No. 4865 to compute each year's "Base Long-Term Rate."[13] CELP next recites the escalation provisions of the Base-Long Term Rate (with reference to docket D83.1.2 and Order 5017) concluding that there was no reference nor legal authority to eliminate "tax effect" in the "applicable Commission orders." CELP adds if

[13] The PSC will note later two other errors in this part of CELP's Response.

the PSC wishes to do so, it must be done prospectively and with application only to contracts signed after a change in methodology is approved. (p. 5) CELP urges the PSC to focus on CELP's First Amendment, which is clearly violated by NWE's "hypothecated" methodology (substituting ARR for ICC and eliminating tax effects). (p. 5)

65. CELP also includes in its February 27, 2007 Response Brief what it labels "**Updated Rates and Payment Schedule.**" CELP asserts it received around January 10, 2007 a proposed rate adjustment by NWE that contained errors, some as basic as incorrectly setting forth purported actual payments, but which failed to properly calculate the rates owed. CELP said it raised these issues in its Motion and that it advised NWE's accounting department. CELP asserts these issues cannot be concluded until NWE's errors, omissions and "creative accounting" are resolved and the correct amount owed CELP is determined. Unless NWE explains its errors, manipulations and misinterpretations as outlined in CELP's petition for reconsideration so that the dispute is resolved in this proceeding, CELP will have no choice but to bring to the PSC a separate complaint against NWE. Any additional legal proceedings to resolve amounts owed to correct interim rates should be unnecessary if NWE will correct its calculations and act in accord with PSC orders and other stipulations in the present proceeding.

66. NWE Reply On March 1, 2007 NWE replied to CELP's motion on the issue of tax effects and asserts CELP has again thrown around the phrase "arbitrary and capricious." The PSC has addressed this and CELP has presented no new argument. CELP does attempt to inject its "contract formulae," tying its argument back to the "negotiations" time frame. CELP's arguments, if valid, are not properly before the PSC. As to this issue, the PSC should deny CELP's motion.

67. NWE Consolidated Second Reply In its March 15, 2007 Reply, NWE asserts if the PSC chooses to reach to the "merits" of CELP's response, it should not accept CELP's characterization of the tax issue. NWE said CELP begins its third post-hearing brief by again misstating that the central issue of these dockets is whether the PSC and NWE have the authority to change the manner in which rates are to be calculated for the remaining 19 years of CELP's contract. CELP has a pattern of alleging

the PSC has changed the way rates are computed when it disagrees with a PSC decision. The PSC has properly concluded based on evidence presented in the record that NWE included taxes in the calculation of the QFLT rates. CELP has tried to supplant the PSC's proper finding by suggesting NWE managed to create great confusion over whether tax rates were properly included. The record shows NWE's position on taxes has been consistent. CELP, in contrast, "abruptly changed" its position on taxes by conceding its earlier claims, that NWE failed to include tax effects, were not correct. CELP then argued it had new evidence that NWE failed to include tax effects in later filings. At the end of the day, CELP failed to present any credible empirical evidence that taxes are not in rates. CELP has been wrong all along on the exclusion of tax effects and its argument should be rejected.

68. Commission Finding The PSC has general comments about the topic of tax adjusted ICC. When CELP initially testified in 2004 it held there were no contract issues to bring before the PSC. CELP's initial stance changed with the 2006 testimony of Lauckhart. Although Lauckhart was not confident about whether the ICC was adjusted for tax effects, CELP chose to pursue this issue. TR 359 That the CELP related rate issues are significant is evident from NWE's estimate of an incremental cumulative $300 million dollar impact.[14]

69. The PSC responds as follows to CELP's second issue in its Emergency Motion. As this issue includes assertions that expand upon the late arrival of the issue in the proceeding the PSC, in response, must augment its findings contained in Order 6501f. First, the PSC notes CELP has not directly addressed the PSC's Finding of Fact No. 147. As the PSC said, it is essential to understand that MPC's compliance filings, which were approved by the PSC, in December 1983 and June 1984 accounted for tax effects. They did so by including tax effects in conjunction with the net present value of revenue requirement calculations. To adjust the ICC again before use in the ACC would be to

[14] In his May 4, 2006 Surrebuttal, Stauffer said that with the "ratio" of rates and the double counting of taxes CELP would receive a windfall profit for the remaining term of its contract, of about $15.8 Million per year for 20 years. *NWE-5, pp. 9-10.*

account for taxes twice. These MPC compliance filings in D83.1.2 were available to any intervenor to the docket and any party who subsequently contracted, as CELP has, for D83.1.2 QFLT rates. This method of addressing tax effects has continued.

70. Second, CELP seems to suggest the PSC was not at liberty to change the method used in D81. 2.15 when it established a new and revised method to compute avoided cost rates in D83.1.2. The PSC did not have to use any part of the method used in D81.2.15 when it developed the new method in D83.1.2. The PSC retained some parts of the D81.2.15 methodology but then made significant methodological changes in D83.1.2. As a result, the methodologies adopted in D81.2.15 and D83.1.2 while appearing somewhat similar are not the same. Tax effects are included in D83.1.2 rates.

71. Third, CELP's comparison of the 13.15% and 13.90% values from the referenced June 1984 compliance filing (Order 6501f, Finding of Fact 147) to the values for Colstrip 3 & 4 and a CT in Order 4865, 16% and 17% respectively, is not helpful as CELP has confused two different variables in two different dockets. The 16% and 17% values are carrying charges that were illustrative "example rate" calculations in D81.2.15. On the other hand the 13.15% and 13.90% values are the actual ICCs that were used, with tax effects, to compute the ACCs in a 1984 D83.1.2 compliance filing. Thus, CELP has confused variables and values from two different dockets. In addition, the time periods that CELP compared are not the same. The above noted compliance filings in D83.1.2 included the effect of taxes and the method was approved by the PSC. In addition, these assertions and material all appear new relative to CELP's actual testimony.

72. Fourth, the PSC did not violate its own orders in approving MPC's compliance filings nor did it ignore the method and rates from orders in D81.2.15 that were then grandfathered.[15] If the PSC had violated its own orders when it approved of

[15] The PSC's Order 4865 fully contemplated successive refinements involving changes in methodology and grandfathering of D81.2.15 methods (see Finding of Fact Number 12, Order 4865). Then, in Order 5017, D83.1.2, the PSC said it would entertain comments on how to improve the methodology. The PSC further stated: "Although this order at times refers to past orders in Docket No. 81.2.15, it is the Commission's intent that this

MPC's compliance filings that included tax effects in the ACC, the parties to the docket with interest in MPC's rates could have challenged the PSC's approval of MPC's filings. The PSC will not now go back and change a method established in 1983 to compute rates that CELP presently dislikes. The PSC changed the methodology it established in Docket 81.2.15 when it next issued orders in D83.1.2.

73. Fifth, the PSC did not ignore Lauckhart's testimony demonstrating that "in all years prior to 1991" MPC consistently "recalculated" the QFLT rates using the current state and federal income tax rates for that year to determine the ICC. TR 334 In fact, there appears an absence of any such pre-filed testimony by Lauckhart. The PSC has illuminated D83.1.2 compliance filings that predate 1991 in which MPC incorporates tax effects. It is those filings CELP appears to believe are in error while at the same time alleging that MPC consistently "recalculated" the rates using state and federal income tax effects. In addition, as NWE explained, and as the PSC states in Order 6501f (Finding of Fact 112), MPC and then NWE have frozen the levelized fixed charge factor (LFCF) since 1988.[16] The LFCF includes state and federal income tax effects. Thus, whether NWE used the ARR or the ICC, in either case it was with LFCFs that included tax effects. CELP has chosen not to acknowledge this fact, which is why the PSC holds if taxes are used again to adjust the ACC again, then taxes will be double counted.[17]

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order and the Commission's Rules governing QF purchases provide the sole basis for contract negotiations. References to past orders are intended to serve only as information for those interested in the history of the Commission's implementation of PURPA and Montana's "mini-PURPA." "The Commission finds that the methodology developed in Docket No. 81.2.15 is valid and should continue to be used (although with some modification) to compute full avoided cost rates." (see Findings of Fact Number 8, 17, 29 Order 5017, emphasis added)

[16] Finding of Fact Number 66 of Order 6501f provides NWE's explanation of how it includes taxes in the LFCF.

[17] NWE said CELP's position that taxes had been excluded since 1993 is a new argument that first appeared in the hearing. NWE said it is evident from its response to CELP - 042(a) that it included taxes in all years. NWE said any necessary correction of tax effects should not be limited to just one year such as CELP recommends (See NWE's September 13, 2006 Reply Brief to CELP's Response Brief, pp. 8-12).

74. The PSC notes two other errors in CELP's February 27, 2007 Response. First, CELP's assertion that the carrying charges including ICC with tax effect as defined in the glossary to Order No. 5017 are "then" included in Appendix B to Order No. 4865 is logically flawed. CELP's use of the word "then" appears an attempt to suggest a sequence of events that did not occur. Order 4865 preceded the orders issued in D83.1.2. Second, CELP suggests the PSC in its Order 4865 used the term "Base Long-Term Rate." This is also incorrect as the term and its relevance arose in Order 5017, after new contracts based on D81.2.15 and Order 4865 could no longer be signed.[18]

75. As for CELP's February 27, 2007 Response Brief summarized above and involving "**Updated Rates and Payment Schedule.**" This issue does not appear related to any motion for reconsideration and is an apparent new issue. (pp. 7-8) Since CELP asserts to have raised the issue in its Motion, it would be repetitive to address it again. The PSC will address NWE's compliance filing later in this order.

Escalation

76. Each of NWE and CELP filed Motions that involve escalation. NWE filed a Reply to CELP's Motion. This material is reviewed in turn, followed by the PSC's findings.

77. NWE Motion The second issue in NWE's February 5, 2007 Motion involving CELP matters regards the Unit Labor Cost (ULC) escalator used in the 2005-2006 QFLT-1 rates. NWE asserts Finding of Fact Number 152 (Order 6501f) implies, but does not make explicit, the ULC escalator should be corrected. NWE seeks direction from the PSC to make the correction.

78. CELP Motion In this its fifth of five issues in its February 2, 2007 Emergency Motion, CELP asserts to summarize for contract years 2004 and 2005 the adjusted rates based on PSC Order 6501f. CELP said NWE filed a Motion on September 29, 2005 (sic) to amend its 2004 and 2005 avoided cost filings and it requested interim

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[18] See Order 5017, Findings of Fact Number 42 (and footnote) and 69.

rate approval. NWE indicates to have used only three and not four quarters of data. According to CELP, the PSC then "embedded" NWE's revision by ordering CELP's rates adjusted for three years back to the 2003-2004 Contract year. (p. 17) CELP holds the PSC mistakenly approved a serious error in the rates to be retroactively adjusted.

79. CELP said NWE's September 2005 filing included two tables from the Bureau of Economic Analysis (BEA) involving GDP (Gross Domestic Product) data. CELP then asserts NWE did not use information available on the date it purports to have computed the rates in June 2004. That is, when NWE calculated the escalation from GDP price index data as of June 1, 2004 for the 2004/2005 contract year, the BEA GDP numbers NWE used were not available from BEA "given they were as of August 31, 2005." CELP asserts that under the methodology in Order Nos. 5017 and 5017a referenced in its First Amendment NWE may not pick and choose BEA releases to obtain the best rate impact at any time in the future. CELP asserts NWE is "required" to update the annual escalating rates in June of each year for the escalation of the previous year ending on December 31st, therefore NWE "should" use December 31 to December 31 numbers to compute the previous year's escalation per Order No 5017, (p. 19). CELP adds "only data available in the following June may be used for that calculation." (p. 18) CELP said on the website that NWE used the BEA continually "revises its numbers in retrospect during the next year after they are first available." CELP asserts NWE looked at BEA GDP numbers for March 31, 2003 and March 31, 2004 as of August 31, 2005 and did not go back to the original BEA GDP numbers that would only have been available to NWE as of June 1, 2004. CELP also said whereas the PSC urged NWE to be more "transparent," NWE has not taken that direction to heart, but rather surreptitiously manipulated data consistent with its practice of "misleading" the PSC and others. CELP holds that NWE does not get the "double dip" of escalations in 2004 and 2005 by counting escalation in 2005 twice based on BEA updates, or by selectively picking number it likes the most. (p. 18)

80. CELP asserts to report in its Emergency Motion the correct numbers to use. CELP also asserts the difference in the year-to-year changes is critical to its energy and capacity rates (ER_n and CR_n). To illustrate, CELP said that as of June 1, 2004, when

NWE must file to update its avoided cost compliance filing, that NWE reports having used the "March 31, 2003 GDP." CELP adds that notwithstanding the "December – December issue," NWE did not use the March 31, 2003 BEA GDP that was available to it on June 1, 2004. Rather, NWE used the "revised" BEA GDP number for March 31, 2003 as reported by BEA on August 31, 2005. In addition, NWE used the September 2005 BEA GDP number (105.724) instead of the March 31, 2004 number (105.163) when it made its mandatory annual compliance filing on June 1, 2004. (p. 19) The former number is the wrong number to use when correcting the three quarters of data error as the number was not available. Similarly, as of the June 1, 2004 compliance filing, NWE reports using the March 31, 2004 BEA GDP number, but the number which was available on September 1, 2005, and not the number that would have been "contemporaneously" available when it made its 2004-2005 annual avoided cost filing. CELP asserts that "Collectively" with this failure NWE's amended rates produce 2.106% escalation instead of 1.625% escalation. CELP asserts NWE admits the method used to compute CELP's rates changed in year 16 and year 16 rates depend on 2005/06 and 2004/05 rates. Thus, CELP concludes the rates for the prior year's escalation (ESC ER_{n-1} and ESC CR_{n-1}) are critical for determining the appropriate current contract year rates. Further, NWE admits CELP's QF rates depend upon the PSC's calculation of NWE's ICC including tax effect. CELP next asserts that the QFLT variables depend on the PSC's calculation of variables (c) (Baseload real carrying charge) and (d) (CT real carrying charge), both of which require NWE's ICC. (p. 21)

81. CELP concludes by stating there are "many concerns" with NWE's approach and NWE should only use data that was available on the date it was required to make its June compliance filings. NWE's use of the wrong "data points" has had significant and downward effect on CELP's rates.

82. NWE Reply On March 1, 2007 NWE replied to CELP's motion on the issue of "interim rate adjustments to account for 3 quarters." (pp. 6-7) This issue in CELP's motion is not proper. The PSC cannot consider something that was not presented at hearing and that is not addressed in the order. CELP has provided "new testimony and exhibits," supposedly to address an error by NWE. The facts show

unequivocally that NWE filed the requested corrections in September 2005. Lauckhart filed testimony in January 2006, addressing "Other Escalators." CELP's post-hearing effort to require use of a December 31 to December 31 year should not be allowed by the PSC. The motivation behind CELP's effort is to provide CELP more funds: "This Commission should even consider this "new" proposal." (sic) This contract runs from July 1 to June 30th and all annual filings have been filed in compliance with those dates. CELP's attempt to bring in new evidence and to expound new positions is improper under any Rules of Civil Procedure, under MAPA and should be rejected based upon due process. As to this issue, the PSC should deny CELP's motion.

83. Commission Finding The PSC will first provide background information before responding to the Motions. In its September 28, 2005 filing, NWE sought to amend its 2004 and its 2005 Avoided Cost Compliance Filings for the July 2004 to June 2005 and the July 2005 to June 2006 contract years. NWE's filing included the Motion of NWE's Richard Garlish asserting the interests of all parties are fully protected during the period the interim rates will be in effect as the rates would be subject to adjustment back to the effective date, with interest. NWE's filing identified two data errors in its 2004 filing. One error involved the failure to include four quarters (a full year) of data with the "GNP Price Deflator." Allowing for this correction would, other things being equal, lower the real cost of capital. The second error was similar but involved the "Fixed Investment Non-Residential escalator." Allowing for this correction would increase capital cost and O & M escalators used to escalate rate variables. Corrections to the 2004/05 interim approved rates would also carry forward to the 2005/06 interim approved rates. NWE asserts in its September 2005 filing that these corrections will enable NWE to correct overpayments of about $1.9 million to CELP.

84. Also as background, in his January 24, 2006 direct testimony Lauckhart identified avoided cost data in need of annual updating that includes the ULC (Order 6501f, Finding of Fact Number 101). He testified NWE used reasonably fresh estimates of federally-published escalators, a practice that NWE should continue. He also testified NWE correctly computed the annual cost escalators implicit in the GNP-IPD and Non-Residential Fixed Investment (Finding of Fact 101, Order 6501f). Lauckhart said,

however, NWE overstated the annual ULC escalation. In his February 28, 2006 rebuttal testimony Stauffer admits to err in calculating the ULC (Order 6501f, Finding of Fact 110) and recommends using three indices, one of which is the ULC (Order 6501f, Finding of Fact 119).

85. With this background, the PSC responds to the Motions filed by NWE and then by CELP. To respond to NWE's Motion and to clarify the PSC's finding in regard to the ULC correction, NWE must correct the ULC error that CELP identified and that NWE admits to have made.

86. As for assertions in CELP's Motion, the PSC's findings are as follows. First, the PSC disagrees with CELP's assertion that the PSC's findings in Order 6501f explicitly ordered revisions back to contract year 2003/04. For example, the PSC's finding on the ULC error was responsive to CELP's and NWE's testimony, and did not specify the years involved in the correction. Further, due to the absence of any NWE rebuttal testimony responding to Lauckhart's assertion that NWE correctly computed the annual cost escalators implicit in the GNP-IPD and Non-Residential Fixed Investment, the PSC did not explicitly order a revision to either the "GNP Price Deflator" or the Fixed Investment Non-Residential escalator.[19] Based on the Motion's and briefing the PSC will now address issues involving these other indices.

87. Again, CELP's Motion references NWE's September 29, 2005 filing to amend its 2004 and 2005 avoided cost filings involving NWE's use of three and not four quarters of data. According to CELP, the PSC then "embedded" NWE's revision by ordering CELP's rates adjusted for three years back to the 2003-2004 Contract year. CELP said the PSC mistakenly approved a serious error in the rates to be retroactively adjusted. The PSC disagrees with CELP's assertions in its Motion. The PSC only addressed the ULC error identified in Lauckhart's testimony, and not the other two errors

[19] Finding of Fact No. 152 of Order 6501f states: "PSC finds that any dispute that CELP had with NWE's choice of inflation indices appears to be resolved for purposes of computing rates in these consolidated QF dockets."

identified in NWE's September 28, 2005 Motion to amend. Nor did the PSC's Order 6501f mention the 2003/04 contract year in this regard.

88. Whereas the PSC's Order 6501f was silent on the other two errors involving the "GNP Price Deflator" and the "Fixed Investment Non-Residential" escalator (see NWE September 28, 2005 cover letter, p. 2), it now requires the 2004/05 and the 2005/06 interim approved rates to be amended, but only under certain circumstances. [20] If NWE can obtain the original BEA data, as CELP suggests, upon which NWE mistakenly included only three quarters of data, instead of four quarters of data, it may do so to correct the 2004/05 and 2005/06 errors. NWE will have to verify with a letter from the BEA that the data it uses is of the same vintage as in the original filing, and not updated (refreshed) data.

89. Second, if NWE cannot now obtain the original data, then the PSC agrees with CELP's concern over NWE's use of information that was not available on the date it purports to have computed rates. As CELP suggests, NWE will not be allowed to use updated information to amend errors in its interim approved 2004/05 and 2005/06 compliance filings (these two compliance filings as well as the 2003/04 will be corrected as explained elsewhere in this order to replace the ARR with the 9.44% ICC).

90. Third, the PSC will not in these consolidated dockets make as CELP suggests any further revisions to the escalators. CELP suggested implementing a December 31 to December 31 time frame for escalation. This is a new proposal not contained in any CELP testimony. Moreover, this proposal is inconsistent with Lauckhart's testimony asserting that NWE used reasonably fresh estimates. CELP can raise the new issues in a subsequent docket, perhaps the ongoing D2006.6.94 case. The PSC also denied NWE's request to approve of its escalation method and assumptions for all time.

91. Fourth, the PSC will not address again CELP's ICC and tax effect issues. These issues were thoroughly addressed elsewhere in this order.

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[20] Besides CELP, Hanover Hydro and Pine Creek are impacted by QFLT rate changes. DR PSC -126

92. From a due process perspective, the PSC is surprised by this issue in CELP's Motion. As Whitehall Wind noted in its February 27, 2006 response, a party is not allowed to raise new issues in a Motion. While, CELP may have stayed within the confines of a general issue, the dimensions of the issue were not preceded by testimony and for the most part cross the line into the area of new testimony. Just as Whitehall Wind said in its February 27, 2007 response in opposition to the MCC's motion, others have not similarly had the opportunity to rebut the specifics raised now in this CELP Motion.

2. Contract Issues

93. CELP Motion In its third of five issues in its February 2, 2007 Emergency Motion, CELP asserts the PSC is bound by Orders 5017 and 5017a (D83.1.2) and it therefore cannot change the terms and conditions of an executed power purchase agreement. (pp. 6, 14-16) CELP said there is no dispute that the First Amendment is a binding 1988 agreement between MPC and NWE. The First Amendment sets forth a formula for computing rates beginning with and after the 16th contract year. CELP said the PSC's "application" of this formula is "limited" by the policy that it will not change the terms and conditions as they exist in executed contracts and any change to the current methodology will only govern subsequent contracts. CELP asserts there are only two changes the PSC "should consider" in "applying" the formula: (1) those changes to the referenced methodology which were approved by the PSC prior to the execution of the First Amendment in 1988 and (2) any subsequent modification agreed to NWE and CELP that changes the First Amendment.

94. NWE Reply On March 1, 2007 NWE replied to CELP's motion on the issue of upholding the terms of an executed PPA. CELP fails to note the language of "Amendment 1" overcomes its argument that the PSC did not intend to burden any QF contracting party with changes that would impact signed contracts. The "Amendment" clearly notes the parties are aware that annual filings will be made in compliance with D83.1.2 and the filings "must be approved" by the PSC. CELP then presents formulae to

determine rates, noting the rates in years 16-35 will be based on the PSC's annual review and approval based on year 15-16. Thus, whereas CELP "cries foul" based on a "tie-back" to 1988, "it fails to note that by accepting Amendment 1, CELP contractually accepted any requirement relative to a future proceeding, just as this one, via negotiations on its own contract." (p. 5) In Finding of Fact 170, the PSC properly found the "ratio approach" to be a negotiated result, a point CELP would like the PSC to overlook. The PSC's order did not change the terms and conditions of the contract, but instead set forth figures which apply to the contract, figures that apply as negotiated between the parties. If CELP believes the application of those figures is incorrect, the dispute belongs in a court, not before the PSC. Also, CELP's effort to tie the language back to Order 5017 is misplaced as the argument should have been made during the course of the previously approved annual filings or in a court case. As to this issue, the PSC should deny CELP's motion.

95. Commission Finding As CELP's third issue in its Emergency Motion is not directed to any apparent disagreement with the PSC's Order 6501f, no PSC finding is required.

Promptly Assume the Contract

96. CELP Motion In the fourth of five issues in its February 2, 2007 Emergency Motion, CELP asserts the PSC may not retroactively adjust CELP's rates for energy and capacity delivered prior to April 11, 2005. CELP's position is based upon the "application of the doctrine of *res judicata*" to several orders approved by the U.S. Bankruptcy Court for the District of Delaware. CELP asserts that it and NWE entered into a series of stipulations in the NWE bankruptcy proceeding (Docket No. 9312872). CELP summarized facts and attached a memorandum it asserts discusses relevant facts and law that supports its argument. In the first stipulation dated October 10, 2003, NWE agreed to continue paying CELP according to the terms of its power purchase agreement. CELP filed a proof of claim against NWE for amounts NWE owed it for the 2003-2004 contract year. NWE decided on July 16, 2004 to assume CELP's contract under the Bankruptcy Plan and NWE disclosed the amount it owed to CELP. After CELP

disagreed with NWE's "cure amount," the parties entered into a stipulation resolving the undisputed portion of the cure amount for the period ending June 20, 2004, and the Bankruptcy Court approved the stipulation. "The parties" entered into a second stipulation that established the cure amount which was then approved by the Court on April 11, 2005. This stipulation said NWE would pay CELP "the remaining cure amount in full and final satisfaction of all claims related to the CELP date **arising on or before the date of the stipulation.**" (emphasis in original) As any charges under its contract arising on or before April 11, 2005 were resolved in "full and final satisfaction of all claims," CELP concludes any retroactive adjustment would be an attempt to rewrite the earlier stipulations that the Court approved. CELP said the memorandum discusses why such an effort is barred by the application of the doctrine of *res judicata* and would violate the Bankruptcy Court's orders. In turn, any interim rate adjustment ordered by the PSC cannot by law be retroactive to any rates paid to CELP on or before April 11, 2005.

97. NWE Reply On March 1, 2007 NWE replied to CELP's Emergency Motion on the issue of the bankruptcy court order "barring application." (p. 6) As a matter of law, if CELP believes a bankruptcy court order bars a PSC order, CELP must file a motion in the bankruptcy court for enforcement of an order. The PSC cannot enforce nor extend the jurisdiction of the bankruptcy court. Nor can the PSC "reconsider" this argument, as CELP has never before made it or even mentioned it. Thus, the PSC should strike CELP's attempt to add new evidence to this record and should expunge the record of CELP's "late filed exhibits," which were not presented at the hearing, nor have they been seen until CELP's recent motion. No party has had an opportunity to exercise due process rights of discovery, rebuttal, or cross-examination of this new evidence. As to this issue, the PSC should deny CELP's motion.

98. CELP Reply In the fourth of five topics in its March 13, 2007 Reply CELP asserts a federal court order is not a new piece of evidence, as suggested by NWE, over which the PSC has discretion to consider. The stipulation which is embodied in the Federal Bankruptcy Court Order dated April 11, 2005 is the law of the land which is not subject to NWE, CELP or the PSC cross examining a federal judge. CELP, NWE and

the PSC "must comply with the court prior to April 11, 2005" and not alter CELP's rates ordered by the bankruptcy judge. Based on its ICC and current taxes CELP attached Exh F which shows the updated workpapers from Order 4865, Appendices A and B.

99. Commission Finding This fourth issue in CELP's Emergency Motion distinguishes two different jurisdictional venues. The PSC's findings will impact the rates offered under the QFLT tariff.[21] Whether there is a contractual term and, or, condition that fences in the amounts CELP was paid is irrelevant. What is puzzling about CELP's Emergency Motion is the apparent fact CELP had in hand the information contained in this its fourth issue of its Emergency Motion when it earlier sought remedies to the amounts it had been paid. The PSC wonders why CELP sought, for example, in its post hearing briefs in 2006 an escalation adjustment for shorted rates (see Order 6501f, Findings of Fact 158-159 and 163-166).

100. As for CELP's March 13, 2007, Reply, the PSC also wonders why CELP filed Exhibit F updating Order 4865 appendices, given that the QFLT compliance filings and rates are not computed using the Order 4865 methodology. Confusingly, CELP even titles Exhibit F "MPSC Order 5017 QF Rates." This material CELP seeks to inject now has no apparent relevance and will not be addressed further.

CELP/MPC Contract's First Amendment: The Ratio Approach

101. CELP Motion In the Introduction to its February 2, 2007 Emergency Motion CELP made other assertions. First, CELP asserts it negotiated and agreed with NWE that rates would be determined by a formula. CELP adds the PSC's "application of this contractually agreed upon formula is guided and limited by the policy stated in Order 5017 that the MPSC will not change the terms and conditions as they exist in executed

[21] The PSC would note the June 13, 2005 Stipulation filed by CELP and NWE seeking PSC approval of, in part, resolution of the PSC's first additional issue. The Stipulation asserts to moot the first additional issue of whether there are any contract issues between the parties. The Stipulation asserts the issue is mooted by the United States Bankruptcy Court proceeding.

contracts…"[22] (p. 3) CELP said the ICC impacts payments to CELP through two capital cost elements in the 1988 First Amendment (ER_n and CR_n). The equation in the First Amendment defines the energy rate (ER_n):

$$ER_n = [ER_{n-1}] \mathbf{x} [(ESC\ ER_n - PESC\ ER_n) / (ESC\ ER_{n-1} - PESC\ ER_{n-1})]$$[23]

CELP adds that ER_n and CR_n were "frozen" for the first 15 years pursuant to the 1988 amendment. Thus, the value for the ICC had no impact for the first 15 years but will beginning in year 16.[24] In its Emergency Motion, CELP adds the ICC had to have been correctly computed for each of the first 15 years if the capital cost elements of ER_n and CR_n are to be correct in year 16. (pp. 4-5)

102. Second, CELP also asserts in its February 2, 2007 Emergency Motion that the PSC failed to "follow" the procedure in the formula determining CELP's capacity and energy rate which dictates the manner by which the avoided cost rate is to be escalated for years 16 and beyond. (p. 7) CELP said the formula requires the PSC to "use" the escalating energy and capacity rate, as calculated under the methodology set forth in D83.1.2, that "directs" the PSC to "look" to NWE's compliance filing (QFLT-84) as an "example" of the procedure to be "used" to calculate these rates. CELP also said use of the ARR was not previously agreed to by CELP and NWE, or "approved" by the PSC in any order or compliance filing that the formula referenced.

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[22] In its February 2, 2007 Emergency Motion (p. 2), however, CELP asserts that the PSC's inquiry is narrowed to include a review of the methodologies established in the following final orders in D81.2.15 and D83.1.2: 4865 and 4865a, b and c and 5017 and 50117a. (emphasis added)

[23] Where, $ESC\ ER_n$, $PESC\ ER_n$ are respectively the escalating energy rate and the escalating portion of the partially levelized energy rate (all for contract year "n"). The corresponding equation in the 1988 First Amendment for capacity is:

$$CR_n = [CR_{n-1}] \mathbf{x} [(ESC\ CR_n - PESC\ CR_n) / (ESC\ CR_{n-1} - PESC\ CR_{n-1})]$$

[24] Whereas CELP was previously inconsistent about which year corresponds with the 16th year (see Footnote No. 97 of Order 6501f), it now correlates year 16 with the 2004/05 contract year.

103. Commission Finding As for CELP's first assertion, although the proper interpretation of the First Amendment belongs in a court the PSC will continue to require NWE to compute rates that are used in the "formula" contained in the First Amendment. As for CELP's assertion that the ICC had to have been correctly computed for each of the first 15 years, the PSC would note that CELP's witness was not clear on the impact of "each" of the first 15 years on the 16th year.[25] Aside from any confusion on the part of CELP's witness, if CELP is correct about its interpretation, then the PSC is curious why CELP waited 16 years to challenge the basis of and value for rates that get used in the formulas in the first amendment. That CELP chose to wait suggests CELP's interpretation of the First Amendment is possibly a fluid interpretation.[26]

104. As for CELP's second assertion, the PSC would clarify that its charge is to approve of rates compliant with the QFLT methodology established in D83.1.2. How those rates get used in the formula embedded in the First Amendment to the CELP and NWE contract is another matter, and the jurisdiction of the courts. For CELP to now assert D83.1.2 is the docket to which its contract rates must conform is correct, however incongruent that assertion is with CELP's other assertions that D81.2.15 is the docket to which its rates must conform. The PSC finds incomprehensible that part of CELP's assertion that the methodology set forth in D83.1.2 directs the PSC to look to NWE's compliance filing as an "example" of the procedure to be used. The PSC has required NWE to replace the ARR it used with the last approved ICC.

3. Other Issues

Supplemental Information

105. The PSC notes here liberties taken on CELP's part to include new arguments and information in Motions and in briefing. NWE's March 1, 2007 Reply comment

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[25] Lauckhart was not clear as to whether the first 15 years of rates impact the 16th year. TR 330-331, 362-363

[26] Footnote No. 1 to CELP's Motion also appears inconsistent.

asserts CELP has raised issues for the first time in either its Motion or in subsequent briefing.[27] The PSC agrees with NWE's comment. The PSC attempted in this Order to identify such new information. On April 9, 2007, and subsequent to the close of briefing, CELP filed supplemental information. On April 23, 2007 the PSC received NWE's reply and on April 26, 2007 CELP filed its reply to NWE. The PSC finds that neither CELP's April 9, 2007 supplement nor either of NWE's April 23, 2007 reply or CELP's April 26, 2007 reply shall be included in the briefing on Motions as such material is out of time.

Compliance Filing

106. As background, in Order 6501f the PSC required NWE to submit rates that are in compliance with that order. Work papers must show the rate calculations. NWE must also submit work papers that show all adjustments, involving the time-value-of-money, to the interim approved rates in these consolidated QF proceedings. The work papers must be submitted for each individual QF affected by the above findings.

107. CELP Reply CELP's March 13, 2007 Reply contains its fifth of five topics. However, it is unclear to whom CELP is replying. CELP asserts that on or about January 10, 2007 NWE filed a proposed rate schedule for adjusting CELP's "Contract Year 2004 and 2005." CELP asserts NWE failed in many instances to show actual payments to CELP, instead selecting payments unrelated to what CELP was actually paid. CELP holds that NWE chose to ignore the Federal Bankruptcy Court Order and Stipulation fixing rates prior to April 11, 2005. Consistent with NWE's past practices, it again "cherry picked" indexes to select in 2005 and 2006 to minimize payments. CELP asserts the indexes were not available at the time the rates were originally determined. NWE has "unilaterally" selected index prices for April through March each year, even

[27] NWE filed on March 15, 2007 its Consolidated Second Reply Brief, part of which addresses CELP issues. NWE asserts it cannot counter CELP's Response (an apparent reference to CELP's March 13, 2007 Reply). It cannot because CELP did not respond to NWE's Motion. Instead, NWE said CELP used the opportunity to "regurgitate" its own brief in support of its own Motion. As such, NWE said CELP's Response should be given no weight in the PSC's deliberations.

though the D83.1.2 methodology requires January through December (citing to Order 5017, Finding of Fact 50). CELP said that probably the most troubling issue is NWE's "self-serving" selection for 2004 of indexes based on September 2005 adjustments instead of using the June 2004 values and indexes when the methodology requires that the revised rates be calculated "as of June 2004." CELP attached as Exhibit G a revised schedule showing the appropriate amounts NWE owes CELP for contract years 2004 and 2005 above the interim rates paid by NWE consistent with CELP's First Amendment implementing D83.1.2 orders 5017 and 5017a. CELP adds that if NWE cannot comply with D83.1.2 orders and properly compute rates consistently using the same indexes without trying to cheat and deceive CELP, then the PSC must bring NWE into compliance. If the PSC fails, then CELP must seek justice in the courts. CELP adds that since ratepayers have no interest in CELP's rates, NWE shareholders and management appear the only beneficiaries of the PSC's failure to enforce D83.1.2 orders.

108. Commission Finding The matter here involves NWE's compliance filing pursuant to the PSC's Order 6501f. NWE must re-submit compliance tariffs with work papers that conform to this Order on Motions for Reconsideration. If it is evident the filing is not in compliance, the PSC will require revisions.

II. Qualifying Facility-Related Motions for Reconsideration

109. The below findings address parties' requests for reconsideration of certain QF rate and policy decisions in Order 6501f. As in Order 6501f, the below findings fall within the following broad categories: 1) long-term standard QF tariff rate options, 2) other long-term QF tariff issues, including the eligibility threshold and installed capacity limit, and 3) the wind-generated QF energy integration cost.

1. Long-Term Standard QF Rate Options

Rate Option 1

110. Order 6501f directs NWE to replace the current QF-1 tariff rate with two new long-term rate options. Option 1 must reflect the average of the prices in NWE's in July, 2006, power purchase contract with PPL Montana (PPLM), which Order 6501f finds is $49.90/MWh.

111. NWE Motion NWE moves the PSC to reconsider the Option 1 rate. According to NWE, the $49.90/MWh rate in the Order does not accurately reflect the average cost of the PPLM contract. NWE states that the total cost of the contract is $673,159,620 and it provides 13,600,800 MWh over its term, which results in an average unit price of $49.50/MWh. NWE asks the PSC to reconsider and adjust the $49.90/MWh rate accordingly.

112. WHW Response WHW responds that NWE's motion raises new and unsubstantiated arguments and fails to specify the grounds on which Order 6501f is unlawful, unjust or unreasonable. WHW states that while NWE provides no support for its $49.50/MWh calculation it appears NWE may not account for the increasing prices and decreasing volumes in the PPLM contract. WHW states that the PSC correctly took the simple average of the annual prices and there is no need to reconsider or revise the $49.90/MWh rate. However, if the PSC chooses to reconsider the Option 1 rate, WHW states that the PSC should also take into account the 7-year term of the PPLM contract in relation to the 15-year availability of the Option 1 rate. WHW asserts that a 15-year QF

contract based on the 7-year PPLM contract presumes that the avoided cost rate will not increase at all, even for inflation, in years 8 through 15.

113. NWE Reply NWE reiterates that it identified "an arithmetic error in averaging the numbers." NWE also states that in attempting to correct factual inaccuracies it is not introducing new evidence. Therefore, NWE maintains the PSC should disregard "CELP's" (sic) contentions in this regard.

114. Commission Finding Order 6501f, Finding of Fact 184, states that the Option 1 rate "must reflect the simple average of the prices in NWE's July 5, 2006, seven-year power purchase agreement with PPL Montana, $49.90/MWh." Thus, the $49.90/MWh figure is a correct estimate of the simple average of the prices in the PPLM contract. NWE's $49.50/MWh is also a correct estimate but of the weighted average cost of the contract over the seven-year term. According to the terms of the contract, NWE purchases more energy at lower prices in the early years and less energy at higher prices in the later years. Thus, the result of NWE's weighted average calculation is slightly less than a simple average of the contract's quarterly prices. There are likely arguments for and against using either approach to set the Option 1 rate. However, NWE's Motion does not address the merits of the weighted average approach compared to the simple average approach. Rather, NWE asserts $49.90/MWh is mathematically incorrect. Given the specific language in Order 6501f, this is not the case. Therefore, the PSC denies NWE's request for reconsideration.

Rate Option 1 Structure

115. Order 6501f directs NWE to replace its existing QF-1 tariff rate with two new long-term rate options. As just explained, the Option 1 rate must reflect the simple average of the prices in NWE's July 5, 2006, power purchase contract with PPLM. Under Option 1, QFs would be entitled to contract lengths of at least 7 years and up to 15 years. Order 6501f states that the PSC based Option 1 rate on the NWE-PPLM contract because it is a recent contract which begins delivering power in July, 2007, and it generally approximates the avoided cost NWE used to evaluate demand-side resources in its 2005 resource procurement plan as well as the Northwest Power and Conservation

Council's estimate of the cost for new pulverized coal plants.[28] CELP's witness, Orndorff, also testified that the cost of new long-term resources is about $50.00/MWh.

116. NWE Motion NWE states that it supports using the PPLM contract as a reasonable proxy for a new avoided cost-based QF rate option. However, NWE seeks a rate structure that ties payments under Option 1 to a QF's actual hourly production. According to NWE, the rate structure of the PPLM contract is flat because the product is delivered in flat blocks during on- and off-peak periods. NWE states that, in contrast, there is no guarantee that QFs will deliver energy in flat blocks so the PSC must account for variable QF power. According to NWE, with the Option 1 rate structure in Order 6501f, customers would pay more than they otherwise would in most market circumstances. NWE asserts that Option 1 fails to leave ratepayers financially indifferent vis-à-vis alternative power sources and, as a result, undermines the foundation of PURPA. NWE asserts that sufficient record evidence supports allocating Option 1 into sub-periods. NWE's motion offers two possible approaches.

117. Under the first approach, NWE proposes that the PSC use the previous year's Dow Jones Mid-C monthly averages to "shape" the flat $49.90/MWh price into monthly values. NWE would then "allocate" these monthly prices to daily peak, off-peak and weekend prices using the actual values for the month in which the QF's production occurred. NWE states that this approach is consistent with the economic logic that underlies the PSC's Option 2(b) rate.

118. Under the second approach, NWE proposes that the PSC use the cost of the Basin Creek natural gas-fired facility to determine peak and off-peak energy values from the flat $49.90/MWh price. NWE proposes to spread an annualized $101.50/kW fixed cost for Basin Creek to 5,000 annual peak hours, resulting in a peak-to-off-peak rate differential of $20.30/MWh. NWE asserts that this results in a peak rate of $58.40/MWh and an off-peak rate of $38.10/MWh. NWE explains that under this approach QFs would be paid the value of peaking, reflected in the fixed cost of Basin Creek, for energy

[28] See Order 6501f, finding of fact 184, footnote 100.

delivered in peak hours. NWE states that this approach provides rate certainty to QFs and is preferable to a flat rate.

119. WHW Response WHW responds that there is no record evidence to support NWE's claim that Option 1 does not account for variable QF production. WHW maintains that the opposite is true because the PPLM contract contains a flat price and there is no reason to think ratepayers will pay more as a result. WHW asserts that, like the existing QFs, future QFs will be a mix of wind and small hydroelectric resources. WHW states that the PSC cannot legally treat QFs differently than other power suppliers and that the $49.90/MWh Option 1 price is a bargain irrespective of whether QF power is variable, given that current market prices are in the $60.00/MWh range.

120. According to WHW, the flat rate in Option 1 does not necessarily mean ratepayers will pay more for QF power than they would for other power. WHW states that in the case of solar, where most production occurs during peak periods, a flat rate is less expensive for ratepayers than hourly rates. In addition, WHW asserts that NWE fails to show that the Option 1 rate is unlawful, unjust or unreasonable.

121. NWE Reply NWE disagrees with WHW that small wind and hydroelectric generators will deliver flat products and that there is no basis for separate energy and capacity rate components. NWE states that WHW's claim violates any modicum of common sense and is inconsistent with expert witness testimony. NWE urges the PSC to reject "CELP's" (sic) contention.

122. Commission Finding In Order 6501f, the PSC states that "NWE was not consistent in its proposals regarding the mix of energy and capacity rates for the long-term, standard tariff." As a result, the PSC decided, for both simplicity and economic reasons, that the long-term rate options should reflect a single rate element.

123. The inconsistencies Order 6501f refers to include four different capacity costs and three different capacity factors. There was practically no discussion among the parties as to which of NWE's proposals would be most reasonable. NWE's capacity cost alternatives include: $94.71/kW, in NWE's response to PSC-008(e), $82.88/kW, in NWE's response to PSC-086(c), $92.40/kW, in NWE's response to PSC-087(d), and $101.51/kW, provided in NWE's Late Filed Exhibit No. 4. NWE's capacity factor

alternatives, which are used to state capacity costs in terms of per-unit energy costs, include 85%, in response to PSC-008(e), 80.4%, in response to PSC-086(c) and an implied capacity factor of 69.3% in NWE's Late Filed Exhibit No. 4.[29] Using the approach in NWE's response to data request PSC-086(c), the $49.90/MWh total rate approved in Order 6501f can be split into energy and capacity rate components through twelve different combinations of the capacity costs and capacity factors in the record. The resulting energy and capacity rates can then be applied to a hypothetical 10 MW wind QF with a 35% capacity factor to estimate average per unit rates of payment under the different combinations. The result is a range of average per unit rates of payment from a low of approximately $35.00/MWh to a high of about $40.00/MWh, as shown in the following table.

Average per-unit payments to hypothetical 10 MW QF with 35% capacity factor based on PSC-086(c) method of splitting $49.90/MWh total rate into separate energy and capacity rates.

	Assumed capacity cost			
Assumed capacity factor	$94.71/kw (PSC-008(e))	$82.88/kw (PSC-086(c))	$92.40/kw (PSC-087(d))	$101.5074/kw (LFE-4)
85.0% (PSC-008(e))	$38.90	$40.32	$39.17	$38.08
80.4% (PSC-086(c))	$38.16	$39.67	$38.46	$37.30
69.3% (LFE-4)	$35.99	$37.78	$36.34	$34.97

124. There is also an aspect of NWE's method for deriving separate energy and capacity rate components that is not adequately fleshed out in record evidence. Using the separate energy and capacity rates NWE develops in response to PSC-086(c), a QF providing a flat product, i.e., 100% capacity factor, would receive an average, per unit rate equal to 93% of the total, per unit avoided cost.[30] Record evidence does not resolve the appropriateness of this constraint particularly given that the PSC adopts a different basis for NWE's avoided cost than what NWE assumes in its response to PSC-086(c).

[29] Late Filed Exhibit No. 4, p. 5 of 6. 3,424.1 aMW / 4,943.8 MW expected capacity = 69.26%.

[30] NWE response to PSC-086, pp. 4-5. [(4993*24.33)+(3767*18.21)+(16.58*1000*5)]/8760 = 31.16. 31.16 / 33.46 = 93%

125. Finally, NWE neither explains nor justifies an important provision in the proposed QF-1 tariff offered in response to PSC-086(c). Under the proposed tariff, a QF's capacity payment is, in part, a function of the average peak kW the QF provides during peak hours. Peak kW, as defined in the proposed tariff, would be measured based on the minimum one hour demand interval occurring during the period under consideration (e.g., peak hours). A QF's average peak kW would be a key driver of a QF's capacity payment and the reasonableness of using the minimum one hour demand interval during peak hours as the measure of peak kW, especially with regard to wind QFs, is not adequately fleshed out in the evidentiary record.

126. NWE's Motion does not, and cannot, resolve the evidentiary inconsistencies and uncertainties surrounding NWE's proposals to establish separate energy and capacity rate components. In addition, both NWE's recent PPLM contract and the Pacific Northwest bulk power market demonstrate that simple price structures are apparently economically based and sound. Therefore, the PSC denies NWE's Motion. However, the PSC's decision in this case to reject an Option 1 rate structure containing separate energy and capacity rate components is not a rejection of the concept NWE proposes. The PSC has authorized separate energy and capacity rate components in the past. The PSC will reconsider separate energy and capacity rates under Option 1 of the QF-1 tariff schedule in future avoided cost dockets, just as it will again consider simple, economically sound rate structures such as the ones in NWE's contract with PPLM and as in the Mid-C indices.

Rate Option 2(a)

127. Order 6501f establishes two long-term standard QF rate options. The second of these options (Option 2) consists of two sub-options: 2(a) and 2(b). Option 2(a) is designed to reflect NWE's actual hourly incremental market purchases. Option 2(b) is based on market price indices. The PSC has previously established rate options reflective of costs that utilities incur and it does so again in these QF dockets.

128. Under Option 2(a), NWE must compute for each hour the highest-cost 25 MWh market purchases. In turn, a QF is paid the computed highest-cost 25 MWh

purchase cost for corresponding MWh it produces in that same hour. With option 2(a) this calculation will be performed for each hour and the QF paid in accordance with the hours it produces power and the incremental cost that NWE incurred in the same hours.

129. NWE Motion NWE moves the PSC to eliminate Option 2(a). According to NWE, implementing Option 2(a) "will require great administrative effort and subjective interpretation of the [order's] language and its application." NWE states this could result in unfair criticism over transparency, increased regulatory risk and more contentious QF proceedings. NWE states that the subjective nature of Option 2(a) will create uncertainty and ambiguity in the calculation of the rate, which will make financing more difficult for QF developers. NWE also states that the overlap between Option 2(a) and Option 2(b) is so great that there is no incremental value in maintaining both options. NWE finds Option 2(b) far superior because it provides certainty to NWE, the PSC and QFs by linking all aspects of the rate calculation to "a transparent, universally obtainable, reliable and verifiable industry standard resource."

130. If the PSC chooses not to eliminate Option 2(a), NWE asks that the PSC specify the basis for the rate and how to calculate it. NWE asks whether all purchases less than three years in duration must be included in the calculation and whether purchases of one-hour duration are appropriate to include. NWE also asks whether the rate in a particular hour can be zero if NWE makes no hourly purchases or is selling into the market in that hour. Based on recent auction purchases, NWE concludes that Order 6501f establishes a price floor of about $60.00/MWh. NWE states that if the PSC intends to impose a price floor, it must also establish a corresponding ceiling. NWE asserts that market prices spiked above $250/MWh in the past year and that the Company could be subject to "serious consequences" if it is forced to deal with a one-sided and inequitable rate structure. NWE states that it strongly prefers elimination of Option 2(a). However, if the PSC chooses not to eliminate it, NWE urges that the PSC include a ceiling of no more than $80/MWh.

131. WHW Response WHW responds that the PSC should deny NWE's request to eliminate Option 2(a). WHW does not agree with NWE's blanket statement that Option 2(a) will be difficult to administer and overlaps with Option 2(b). In addition,

WHW states that NWE's assertions do not demonstrate that the PSC's decision is unlawful, unjust or unreasonable.

132. NWE Reply NWE asserts that its arguments demonstrated good cause for eliminating Option 2(a) and that the costs of implementing Option 2(a) will outweigh any benefit from retaining that option. NWE states that "CELP" (sic) failed to address an obvious imbalance of costs and benefits and its objection to NWE's motion lacks supporting arguments or rationale.

133. Commission Finding. In Order 6501f, the PSC finds that it is appropriate to establish a QF rate option that is based upon NWE's actual incremental power purchases. The PSC notes that according to NWE's 2005 electric default supply resource procurement plan NWE will purchase approximately 30% of its resource needs from the market. Over the term of the July, 2006, NWE-PPLM power purchase contract, market purchases will grow to over 70% of load. However, even if the amounts purchased were considerable less, the logic of cost-based pricing, and the law, would still support including in prices the incremental costs that NWE incurs.

134. Record evidence supports a market-based standard QF tariff. CELP's witness, Orndorff, contends that the market price NWE avoids should be the basis of payments to CELP for excess power.[31] WHW's witness, Frantz, suggested using a long-term market price forecast as proxy for NWE's avoided costs.[32] He also states that forward prices are relevant and should be considered in avoided cost calculations.[33] In addition, NWE used the Northwest Power and Conservation Council's forecast of the levelized value of Mid-Columbia market prices as the basis for an avoided cost-based cost-effectiveness threshold for evaluating demand-side resource options in its 2005 electric default supply plan.[34]

135. There are other justifications for Option 2(a). First, given the PSC's decision (discussed below) requiring wind QFs to absorb the cost of integration services needed to firm up their power production, it is appropriate to offer these QFs a rate option

[31] NWE response to PSC-021
[32] NWE response to PSC-114
[33] NWE response to PSC-115

that reflects the incremental costs NWE incurs to acquire firm power in the market place. Second, since Mid-C market values are weighted averages of market tranactions, they do not reflect incremental costs that NWE incurs and therefore an option that does reflect NWE's incremental costs is appropriate. Third, relying solely on the Mid-C market as a rate option would not be satisfactory given NWE's own characterization of the market as "dysfunctional." Fourth, in most hours, market purchases will represent the incremental cost to NWE that could be avoided through QF purchases. For this reason Order 6501f finds Option 2(a) is an appropriate long-term tariff option.

136. NWE requests that the PSC specify the basis for the rate and how to calculate it, specifically whether all purchases less than three years in duration must be included in the calculation and whether purchases of one-hour duration are appropriate to include. In Order 6501f the PSC directed NWE to exclude its recent contract with PPLM, existing QF contracts and short-term (3-5 years) products procured through auctions (see finding of fact 190, Order 6501f). The PSC modifies that finding, slightly. NWE must exclude from its calculation of the highest-cost 25 MWh market purchases any resource that it acquired through an RFP or competitive solicitation process (e.g., formal auction process) as well as any and all QF contracts and other pre-existing long-term contracts(e.g., Tiber, Judith Gap, Colstrip 4). What remains are purchases of power that NWE must include in its estimate of Option 2(a).

137. NWE also asks whether the rate in a particular hour can be zero if NWE makes no hourly purchases or is selling into the market in that hour. The PSC finds that the rate could be zero if in any hour NWE makes no purchases after carving out the resources acquired as noted above. It matters not if a contract is an hourly contract or a longer duration contract, if it was not acquired in a competitive solicitation, the cost must be included. Thus, there could be hours in which the cost is low or zero, however the PSC doubts this will be of consequence. And, furthermore Option 2(a) is just that, an option. If QF's wish not to take the risk of a zero price in an hour, they can always opt for one of the other two rate options. Just as the PSC will allow a floor of zero, the PSC

[34] See Order6501f, finding of fact 184, footnote 99.

will not set a cap on the cost that NWE can incur to purchase power in the market. In turn, the PSC will not set a cap on the price that NWE must in turn pay QFs under Option 2(a). To do so would unfairly treat QFs having to newly contract with NWE, given they will be responsible for the cost of firming.

138. The PSC disagrees with NWE's assertion that the overlap between Option 2(a) and Option 2(b) is so great that there is no incremental value in maintaining both options. The Mid-C is a weighted average rate in what NWE labeled a dysfunctional market. In contrast, Option 2(a) is based upon incremental purchases of power. Obviously the two could not be more different economically speaking. In addition, Option 2(a) is compliant with the law.

2. Other Long-Term QF Tariff Issues

Eligibility Threshold for Standard QF Tariff

139. PSC administrative rule 38.5.1902(5) states that long-term contracts for purchases and sales of electric energy between utilities and QFs greater than 3 MW in size shall be contingent on a utility's selection of the QF in a competitive solicitation. Order 6501f requires NWE to adopt a tariff that makes long-term standard rates available to QFs 10 MW or smaller.

140. MCC Motion The MCC moves the PSC to reconsider the decision to make long-term standard tariffs available to QFs up to 10 MW in size. The MCC states that the PSC's primary responsibilities do not include promoting renewable energy. Rather, the PSC's primary responsibilities are to balance the interests of ratepayers and the utility and ensure the utility provides reasonably adequate service at just and reasonable rates while preserving the utility's financial stability. The MCC states that the federal PURPA, Montana's Mini-PURPA, and federal and state regulations implementing these laws are designed to encourage development of competitive generation while leaving ratepayers indifferent to the source of the electricity they ultimately purchase.

141. The MCC calls the record on which the PSC bases its decision "thin." The MCC states that the only rationale the PSC provides for the change to a 10 MW threshold

is that it appears reasonable because of other states' and FERC's actions. The MCC finds that the only record evidence regarding a 10 MW threshold is in the testimony of WHW witness Frantz, and that testimony is based solely on action in Idaho with no further rationale.

142. The MCC asserts that because the PSC adopted a rule establishing a 3 MW threshold, it cannot change that threshold in a contested case. According to MCC, the Montana Administrative Procedures Act (MAPA) requires the PSC to follow certain procedures before adopting, amending or repealing a rule. The MCC states that the PSC violated those procedures by changing the substance of a rule in a contested case. MCC therefore concludes that the amendment to the 3 MW rule the PSC attempts to make in Order 6501f is invalid under § 1-4-102(13)(a), MCA, which states:

> "Substantive rules" are…legislative rules, which if adopted in accordance with this chapter and under expressly delegated authority to promulgate rules to implement a statute have the force of law **and when not so adopted are invalid….**[emphasis added in MCC Motion].

143. The MCC also states that the PSC's decision to change the threshold is flawed because the threshold in the rule reasonably balances the requirements of PURPA with the PSC's responsibility to ratepayers while ensuring NWE's financial integrity. MCC asserts that the competitive solicitation process sets the long-term avoided cost for QFs larger than 3 MW and satisfies the requirements of PURPA. MCC states the 10 MW threshold benefits QFs in the 3 – 10 MW range by making them eligible for a "generous standard offer," but harms ratepayers through the elimination of competitive pressure. MCC asks the PSC to reconsider its decision to make long-term standard tariffs available to QFs larger than 3 MW.

144. NWE Motion NWE states that it supports the arguments in MCC's motion on this issue.

145. WHW Response WHW asserts that the PSC's decision to increase the threshold from 3 MW to 10 MW is supported by substantial evidence. WHW contends that MCC overlooks internal work by PSC staff as well as testimony and exhibits offered by parties to this proceeding. According to WHW, the fact that Oregon and Idaho have

adopted a 10 MW threshold, and Montana QFs larger than 3 MW are selling to Idaho, indicates that Montana's "law" (sic) is not up to date.

146. WHW disagrees with MCC that the PSC's decision violates MAPA. According to WHW, MCC fails to acknowledge that multiple PSC notices in this proceeding identified the eligibility threshold as an issue. WHW maintains that all parties were offered an opportunity to be heard on this issue, and several offered testimony. In addition, WHW asserts that administrative agencies often have flexibility to decide how to address important policy issues and are free to announce new policies in contested case proceedings. WHW does not agree that the PSC's actions violate MAPA, but even if they do, WHW states that the solution is for the PSC to now implement its decision by revising its administrative rule.

147. Commission Finding Early in this proceeding, the PSC indicated its interest in exploring the appropriateness of the existing 3 MW size threshold that determines eligibility for long-term standard QF tariffs. In September, 2003, the PSC issued a Notice of Additional Issues indicating that the current 3 MW threshold is but one possible threshold. NWE and WHW prefiled direct testimony on the threshold issue.[35]

148. The basis for maintaining long-term, standard tariffs is rooted in PURPA's mandate to encourage QF power production along with the transaction cost-based market barriers small QFs face when negotiating contracts with monopoly utilities. The question in this case is whether QFs seeking to develop projects in Montana that are larger than 3 MW face market barriers in spite of PURPA's mandatory purchase provisions. Order 6501f finds that QFs 10 MW or less should be eligible for standard tariffs. The Order supports this threshold by referencing orders adopted by other states, and contained in the record evidence in this case, as well as the Federal Energy Regulatory Commission's recent rules implementing the 2005 Energy Policy Act.

50 MW installed capacity limit

[35] See Order 6501f, findings of fact 55, 81-83, and 107-109.

149. Order 6501f establishes a 50 MW installed capacity limit on new QFs that contract with NWE under the long-term standard rate options. The Order states that the PSC will consider whether to revisit its QF policies upon reaching the 50 MW installed capacity limit. The Order expresses the PSC's desire for a diverse mix of new, small QFs (*e.g.*, small hydro, biomass, cogeneration, wind) and states that the PSC may act in the future to assure diversity prior to reaching the 50 MW installed capacity limit.

150. MCC Motion MCC states that Order 6501f may commit NWE and its customers to excessive costs for up to 20 years. Rather than reviewing its QF policies upon reaching 50 MW of installed new QF capacity, MCC requests that the PSC review the policies after one year or after no more than 10 MW of new QF capacity are installed.

151. NWE Motion NWE states that it supports the arguments in MCC's motion on this issue.

152. WHW Response WHW responds that the bulk of MCC's arguments relate to NWE's experience with Judith Gap, which is not a QF, and assertions regarding wind generation equipment that are not supported by record evidence. WHW asserts that MCC's arguments are pure speculation and appear to be an attempt to foreclose QF development and scare the PSC into second-guessing itself. WHW states the PSC must reject MCC's arguments on this issue and uphold Order 6501f.

153. Commission Finding The objections MCC and NWE raise regarding the 50 MW installed capacity limit are made moot by the PSC's decisions in this order regarding the wind generated QF energy integration charge. Additionally, while Order 6501f states the PSC's intent to consider revisiting QF policies upon reaching 50 MW of installed new QF capacity, nothing prevents NWE or other parties from petitioning the PSC to address such issues prior to reaching that threshold. The PSC would add that the 50 MW capacity limit applies to new contracts, i.e., ones that are in addition to contracts that expire and have to be renegotiated.

3. Wind-Generated QF Energy Integration Charge

154. In Order 6501f the PSC finds that wind-generated electricity production is highly variable and presents particular challenges with regard to day-ahead and hour-ahead system planning, and intra-hour system operations. The Order states that NWE has experienced more challenges integrating wind resources than other utilities in the Western Electricity Coordinating Council (WECC) reliability region due to its relatively small control area, lack of owned or dispatchable resources, and a limited and relatively expensive ancillary services-integration market. The Order states that wind's unique production characteristics must be considered in developing standard rates under PURPA. The Order acknowledges that there is limited evidence in the record on integration costs and their effect on NWE's avoidable costs. However, to preserve the principle of customer indifference to a utility's purchase of QF power in place of the power the utility would otherwise have acquired, the Order establishes an estimate of incremental integration costs for QFs using wind generators. Citing a likely range of $5.00/MWh to $10.00/MWh for the cost of wind integration identified in Order No. 6633b, Docket No. D2005.2.14, Order 6501f establishes a $7.50/MWh proxy integration cost for QFs entering contracts under the standard long-term rate options. That is, wind QFs that do not separately arrange for integration services, but instead rely on NWE to integrate the intermittent energy delivered by the project, must pay NWE $7.50/MWh for each MWh delivered.

155. WHW Motion WHW states that the PSC wrongly establishes a proxy for wind integration costs. In addition to contending that *ex parte* contact occurred on this issue, WHW asserts that the proxy wind integration cost is not based on record evidence and, therefore, reflects an arbitrary and capricious decision by the PSC which denies WHW due process. WHW states that Order 6501f cites no record evidence to support the proxy wind integration charge, instead referring to other dockets. WHW also asserts that wind integration issues were first raised post-hearing and post-closing of the evidentiary record, a fact demonstrated by the absence of a proposal for an integration or ancillary services charge in staff's draft order. WHW states that the PSC established the wind integration charge as a result of meetings between one or more commissioners and representatives of NWE during which NWE indicated that the Company did not want any

more wind until it learned more about risks associated with the Judith Gap project. According to WHW, it appears that the PSC belatedly tried to address concerns regarding potential wind integration costs by referencing other dockets containing information on wind generation. WHW asserts this approach denies it, and other parties, their right to rebut or respond to evidence the PSC considers in making its decision. WHW concludes that the PSC errs by adopting a wind integration charge at $7.50/MWh or any other rate without supporting evidence.

156. MCC Motion MCC asserts that the PSC's approach in Order 6501f shifts too much risk to NWE and its ratepayers. MCC appears to share WHW's view that the range of integration costs identified in another docket is not an adequate basis for the proxy wind integration charge the PSC establishes in this proceeding. MCC also doubts that NWE's experience with Judith Gap will apply to small QFs which may employ older, less reliable machines without remote meteorological monitoring. In addition, MCC asserts that there is great uncertainty over the future price and availability of integration services, both for Judith Gap and new QF projects. MCC asks the PSC to consider requiring QF contracts to contain annual "reopener" clauses so that the contracts will reflect actual integration costs over the life of the projects.

157. NWE Motion NWE states that it supports the arguments in MCC's motion on this issue.

158. NWE Response NWE disagrees with WHW that wind integration issues only arose post-hearing and post-closing of the record. NWE asserts that wind integration issues were discussed throughout the proceeding. NWE states that it proposed separate energy and capacity payments in order to appropriately account for the cost of ancillary services. NWE notes that its witness, Stauffer, testified at the hearing on the cost of ancillary services and that TDW's witness, Jamison, testified that it would be appropriate to set QF rates that reflect the differences in products that different QFs might provide.

159. WHW Reply WHW, while acknowledging the importance of integration costs, replies that the PSC should debate the issue in a forum where the parties have an equal opportunity to discuss it with commissioners and staff, and it is too late to do that in

this Docket. Citing provisions in MAPA and various court cases, WHW reiterates that record evidence does not support the $7.50/MWh integration charge Order 6501f establishes for wind QFs. WHW disagrees that the testimony at the hearing by Stauffer and Jamison constitutes sufficient evidence in support of a specific wind integration charge. WHW also asserts that neither the PSC nor other parties provided sufficient notice that a specific integration charge would be considered and no party offered testimony on a specific wind integration charge. According to WHW, the PSC's reliance on two different dockets (D2005.2.14 and D2006.5.66) to justify the wind integration charge demonstrates that the record in this proceeding is devoid of evidence to support the charge.

160. With regard to Stauffer's testimony at the hearing on wind integration, WHW asserts that Stauffer's proposal was for separate energy and capacity rate components. WHW states that the Order 6501f considered and rejected Stauffer's proposal. WHW finds illogical NWE's use of Stauffer's testimony to support a separate wind integration charge, asserting that the two issues are not the same. WHW states that if the two issues are the same, it would not be possible for the PSC to simultaneously reject Stauffer's proposal for separate energy and capacity rate components while adopting a wind integration charge. In addition, WHW states that if the two issues are the same, its contention of *ex parte* communication is stronger because discussing integration issues would be equivalent to discussing specific issues in this proceeding, namely separate energy and capacity rate components.

161. WHW reiterates that the best evidence that wind integration issues arose post hearing, apart from PSC staff's draft order, is that no party submitted prefiled testimony on wind integration, mentioned it at the hearing or discussed it in post-hearing briefs. WHW maintains that the first time the issue came up was in post-hearing statements by Commissioner Molnar and that there is no question that NWE met with at least one Commissioner *ex parte* about wind integration following the PSC's rejection of NWE's proposal for separate energy and capacity rate components.

162. Commission Finding. Early in this proceeding the PSC sought information regarding the unique operational characteristics of wind QFs and associated implications

for setting avoided cost-based rates. In its September, 2003, Notice of Additional Issues the PSC explicitly asked parties to address in prefiled written testimony the merits of separate, nondiscriminatory rates for various QF technologies, including wind. The PSC made note of the fact that this issue also arose during the public hearing in D2002.6.63 regarding NWE's application for approval to extend the availability of the QF-1 tariff schedule.

163. NWE witness Stauffer submitted prefiled additional issues testimony stating that differentiating QF rates based on generation technology would not be necessary if the standard rate was separated into energy and capacity rate components. Attachment 3 to Stauffer's additional issues testimony contains responses to PSC data requests in D2002.6.63. One of the data requests, PSC-003, asks NWE about the appropriateness of using a contract with Tiber Montana as a proxy for avoided costs. NWE's response states that the price of power from Tiber would not necessarily provide a reasonable proxy because the project provides fairly stable energy unlike intermittent resources that cause NWE to incur additional capacity and integration service-related costs. In rebuttal testimony filed March 1, 2006, Stauffer defended NWE's proposal for separate energy and capacity rate components as a way of accounting for the intermittent nature of some resources. WHW witness Frantz prefiled direct testimony stating that it is "**undeniably** true" (emphasis added) that intermittent resources require a corresponding firming obligation. [36] In addition, TDW witness Jamison testified at the hearing that it would be appropriate to set QF rates that reflect the differences in products that different QFs might provide.[37] WHW's reply brief (on motions for reconsideration) also acknowledges that integration issues are valid and should be considered, albeit in another forum.

164. Contrary to WHW's assertions in its motion and reply, the PSC provided adequate notice of wind integration issues. In fact, several parties, including WHW prefiled testimony addressing the issues and discussed them at the hearing. Thus, WHW is not correct that wind integration issues only arose post-hearing and post-closing of the record. The record contains ample evidence of the PSC's interest in wind's intermittent

[36] January 24, 2006, Prefiled Direct Testimony of Robert P. Frantz, p. 7. See also Transcript, p 405.

production profile in relation to setting QF rates that produce payments to wind QFs that accurately reflect NWE's avoided costs. However, Order 6501f concedes that in this proceeding the PSC garnered limited evidence on the likely magnitude of wind integration costs. The $7.50/MWh proxy wind integration charge in Order 6501f is an attempt to resolve the issue in this case pending refinement of the policy in future cases.

165. WHW and MCC both contend that there is insufficient record evidence on which to base a specific wind integration charge. WHW's proposed solution is to eliminate the charge and address the issue in another proceeding. Under this approach, until the PSC completes another proceeding, QFs could enter long-term contracts that do not address integration. MCC's proposed solution is to require QF contracts to include re-opener clauses so that if NWE's actual integration costs are different than $7.50/MWh, the charge could be adjusted.

166. The PSC agrees with WHW that it is not possible to derive a record-based, specific wind integration cost. However, record evidence indicates that integrating wind QFs is not costless. Accounting for wind integration in determining standard, avoided cost-based QF payments is both solidly supported by the record and appropriate. Therefore, the PSC finds that new contracts between NWE and wind QFs must include specific wind integration provisions. A QF may arrange for integration services on its own, as Order 6501f states. Alternatively, NWE and the QF must attempt to negotiate a mutually acceptable arrangement that reflects the QF's particular size, location, wind regime, production profile and other project characteristics. NWE must document its good-faith efforts to negotiate such arrangements, including an assessment of the potential for geographic diversity benefits. To the extent NWE and a QF cannot agree to mutually acceptable contract arrangements, either NWE or the QF may petition the PSC under § 69-3-603, MCA, for a determination of an integration arrangement. If NWE initiates a PSC determination it must include documentation of the negotiations. If a QF initiates a PSC determination, it must copy NWE with the petition and NWE must immediately provide the PSC documentation of the negotiations.

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[37] Transcript, p. 272.

CONCLUSIONS OF LAW

167. All PSC statements in the above paragraphs, whether generally categorized as introductory, findings, discussions, determinations, or other, that can properly be considered conclusions of law and that should be considered as such are incorporated herein as conclusions of law.

168. NWE is a "public utility" within the meaning of that term as applied in Montana laws pertaining to public utility regulation administered by the PSC. *See e.g. § 69-3-101, MCA.* As a part of NWE's public utility operations NWE supplies electricity in a manner regulated by the PSC and NWE is therefore a "utility" and "electric utility" within the meaning of those terms as applied in Montana and federal laws administered by the PSC and related to utility obligations to purchase power from small power production facilities. *See e.g. § 69-3-601(4), MCA.*

169. NWE's applications in these three consolidated dockets have been properly noticed, processed, and heard in accordance with the procedural laws governing matters before the PSC, including provisions within the Montana Administrative Procedure Act, *Title 2, Ch. 4, MCA*, the procedural requirements of the statutes governing PSC procedures, *Title 69, MCA*, the procedural rules of the PSC, *ARM Title 38, Ch. 2*, and all PSC procedural orders governing these consolidated dockets.

ORDER

Done and dated this ? th day of May, 2007, by a vote of –? -?.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

_____
GREG JERGESON, Chairman

_____
DOUG MOOD, Vice Chairman

_____
BRAD MOLNAR, Commissioner

_____
ROBERT H. RANEY, Commissioner

_____
Ken Toole, Commissioner

ATTEST:

Connie Jones
Commission Secretary

(SEAL)